SUBJECT INDEX

Page

Additional Citations to Opinions Below 1

Statutory Provisions Involved 2

Statement of the Case 4

Argument 8

I.

The Interlocutory Order Involved Herein Was Not an Appealable Order Because It Did Not Substantially Determine Any Issue 8

II.

Petitioners Are Not Aggrieved Parties and Lack Standing to Appeal 12

A. Petitioners Are Not Aggrieved Parties 12

B. Petitioners Have No Valid Claims Against EFCA and Therefore Lack Standing to Prosecute This Appeal 13

III.

Conclusion 15

INDEX TO APPENDICES

Page

Appendix A. Memorandum and Order Approving Plan of Reorganization .....App. p. 1

Appendix I. New Company Projected Cash Flow.

Appendix II. Projected Consolidated Earnings (GAAP).

Appendix III. New Company—Reorganization Value at March 31, 1976.

Appendix B. Order 56

Appendix C. Order (1) Confirming the Trustee's Plan; (2) Authorizing Substantial Consummation of the Trustee's Plan; (3) Appointing Directors and Officers; (4) Providing for Notice .. 57

Appendix D. Order in Aid of Substantial Consummation 64

Appendix E. Memorandum and Order on Objection to Claim No. C-0663 Filed on Behalf of Marvin Al Lichtig 79

Appendix F. Memorandum and Order on Objection to Claim No. C-0661 Filed on Behalf of Curtis B. Danning, Trustee for Solomon Block, Bankrupt 86

TABLE OF AUTHORITIES CITED

Cases	Page
Carolina Mills, Inc. v. Corry, 206 F.2d 76 (4th Cir. 1953)	9
Chicago Rapid Transit Co., In re, 200 F.2d 341 (7th Cir. 1953)	8, 10
DCA Development Corporation, In Re, 489 F. 2d 43 (1st Cir. 1973)	13
Dubnoff v. Goldstein, 385 F.2d 717 (2nd Cir. 1967)	9, 10
Durensky, In re, 519 F.2d 1024 (5th Cir. 1975)	8, 9
Federal Land Bank of Springfield v. Hansen, 113 F.2d 82 (2nd Cir. 1940)	10
Hotel Governor Clinton, In Re, 107 F.2d 398 (2nd Cir. 1939)	10
Klein v. Rancho Montana de Oro, Inc., 263 F. 2d 764 (9th Cir. 1959)	12
Marks v. Brucker, 434 F.2d 897 (9th Cir. 1970)..	13
United States of America v. Goldblum, et al., Case No. CR 13390-JWC	14
Wells v. Dickinson, 403 F.2d 635 (6th Cir. 1968)	13
Rules	
Federal Rules of Appellate Procedure, Rule 4(a) ..	13
Federal Rules of Appellate Procedure, Rule 6	13
Statutes	
Bankruptcy Act, Sec. 24(a) (11 U.S.C. § 47(a)..	8
Bankruptcy Act, Sec. 25 (11 U.S.C. § 48)	12, 13
Bankruptcy Act, Sec. 167(b) (11 U.S.C. § 567(b)	4

Page

Bankruptcy Act, Sec. 172 (11 U.S.C. § 572 ....2, 3, 4, 10, 11

Bankruptcy Act, Sec. 174 (11 U.S.C. § 574 .....3, 11

Bankruptcy Act, Sec. 221 (11 U.S.C. § 661) 3, 6

Textbooks

2 Collier on Bankruptcy, ¶ 24.39 (14th ed. 1972) 8, 9

2A Collier on Bankruptcy, ¶ 25.08 (14th ed. 1975) 13

IN THE

Supreme Court of the United States

October Term, 1975
No. 75-1156

CURTIS B. DANNING, Trustee for the Estate of Solomon Block, and MARVIN A. LICHTIG,

Petitioners,

vs.

ROBERT M. LOEFFLER, Trustee,

Respondent.

Brief in Opposition to Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

The Respondent, Robert M. Loeffler (the "Trustee"), for the Estate of Equity Funding Corporation of America, respectfully prays that the Petition for Writ of Certiorari to review the dismissal of the appeal of Curtis B. Danning, Trustee for the Estate of Solomon Block, and Marvin A. Lichtig by the United States Court of Appeals for the Ninth Circuit be denied.

Additional Citations to Opinions Below.

The Memorandum and Order of the United States District Court for the Central District of California Approving Plan of Reorganization, dated December 8, 1975, is attached hereto as Appendix A.

The Order of the Court of Appeals for the Ninth Circuit denying petitioners' motion for a stay, dated February 18, 1976, is attached hereto as Appendix B.

The Order of the United States District Court for the Central District of California (1) Confirming the Trustee's Plan; (2) Authorizing Substantial Consummation of the Trustee's Plan; (3) Appointing Directors and Officers; and (4) Providing For Notice, dated February 23, 1976, is attached hereto as Appendix C.

The Order of the United States District Court for the Central District of California in Aid of Substantial Consummation, dated February 25, 1976, is attached hereto as Appendix D.

The Memorandum and Order of the Bankruptcy Judge sustaining the Trustee's objections to the claims of Marvin A. Lichtig, dated January 15, 1976, is attached hereto as Appendix E.

The Memorandum and Order of the Bankruptcy Judge sustaining the Trustee's objections to the claims of Curtis B. Danning, dated January 15, 1976, is attached hereto as Appendix F.

Statutory Provisions Involved.

Section 172 of the Bankruptcy Act, 11 U.S.C. § 572, provides:

> "Sec. 172. After the hearing, as provided in section 169 or section 170 of this Act, and before the

BLEED THROUGH

approval of any plan, as provided in section 174 of this Act, the judge may, if the scheduled indebtedness of the debtor does not exceed $3,000,000, and shall, if such indebtedness exceeds $3,000,000, submit to the Securities and Exchange Commission for examination and report the plan or plans which the judge regards as worthy of consideration. Such report shall be advisory only."

Section 174 of the Bankruptcy Act, 11 U.S.C. § 574, provides:

"Sec. 174. After the hearing, as provided in section 169 or section 170 of this Act, and, if a plan has been submitted to the Securities and Exchange Commission, as provided in section 172 of this Act, then after the filing of the report or notice that it will not be filed, or after the expiration of the time for its filing, whichever first occurs, the judge shall enter an order approving the plan or plans which in his opinion comply with the provisions of section 216 of this Act, and which are fair and equitable, and feasible, and shall fix a time within which the creditors and stockholders affected thereby may accept the same."

Section 221 of the Bankruptcy Act, 11 U.S.C. § 661, provides in part:

"Sec. 221. The judge shall confirm a plan if satisfied that—

". . .

"(2) the plan is fair and equitable, and feasible;"

Statement of the Case.

On April 5, 1973, Equity Funding Corporation of America ("EFCA") filed a Petition for Reorganization under Chapter X of the Bankruptcy Act (the "Act") in the United States District Court for the Central District of California (the "District Court"). EFCA's petition was granted on the same day. On October 24, 1974, after lengthy and arduous investigations, discussions with representatives of the various groups of creditors, and the solicitation of suggestions for a plan of reorganization pursuant to Section 167(b) of the Act (11 U.S.C. § 567(b)), the Trustee proposed a plan for the reorganization of EFCA. Hearings on the proposed plan commenced December 9, 1974 and continued from time to time until December 8, 1975.

By order dated July 24, 1975 (the "SEC Submission Order") an amended version of the plan originally proposed (the Trustee's Amended Plan of Reorganization; hereafter referred to as the "Trustee's Plan") was submitted to the Securities and Exchange Commission (the "SEC") for its expert advice pursuant to Section 172 of the Act (11 U.S.C. § 572), quoted above.

On November 25, 1975, the SEC issued its Advisory Report which concluded that the Trustee's Plan "may be found to be fair and equitable and feasible."

Under Section 172, the submission of the Trustee's Plan to the SEC constituted nothing more than a

BLEED THROUGH

step preliminary to the approval or rejection of the Trustee's Plan and did not determine any substantial issue in the reorganization proceedings. Despite this fact, petitioners herein elected to notice the present appeal.* On motion of the Trustee, the Court of Appeals dismissed the appeal on November 19, 1975 on the ground that it lacked jurisdiction.

After review of the Advisory Report of the SEC, as well as the evidence adduced during the hearings on the Trustee's Plan, the memoranda filed by parties to the proceeding, the arguments of counsel, and the files and records of the entire bankruptcy proceeding, the District Court on December 8, 1975, issued its Memorandum and Order Approving Plan of Reorganization (the "Approval Order"), a copy of which is attached hereto as Appendix A. In its Approval Order, the District Court concludes:

> "that the Trustee's Plan complies with Section 216 of the Bankruptcy Act (11 U.S.C. § 616); *that the Plan is 'fair and equitable and feasible' within the meaning of Section 174 of the Bankruptcy Act* (11 U.S.C. § 574); and that the Plan should be approved. Therefore, pursuant to Section 174 of the Bankruptcy Act (11 U.S.C. § 574), the Court approves the Plan and orders that it be transmitted to the creditors of the estate for their acceptance or rejection, in accordance

*Solomon Block was an employee of the outside accounting firm which audited EFCA. Marvin A. Lichtig also was associated with that firm until 1969, at which time he became Executive Vice President—Administration and Treasurer of EFCA.

with the terms of the Orders herein dated December 8, 1975." (App. A-2.)*

On December 19, 1974, petitioners herein filed a Notice of Appeal from the Approval Order and on January 12, 1976, filed a motion for a stay pending the appeal. On February 18, 1976, the Ninth Circuit Court of Appeals issued an Order denying petitioners' motion for a stay, a copy of which is attached hereto as Appendix B.

Pursuant to the District Court's Approval Order, the Trustee's Plan was submitted to the creditors of EFCA for their acceptances or rejections. On February 23, 1976, the Trustee filed a Certificate of Trustee re Acceptances or Rejections of the Trustee's Plan, which certified that the Trustee's Plan had been accepted in writing by or on behalf of creditors holding two-thirds in amount of claims filed and allowed for purposes of voting in the requisite classes defined in the Trustee's Plan. That same day, pursuant to Section 221 of the Act (11 U.S.C. § 661), the District Court entered its Order (1) Confirming the Trustee's Plan; (2) Authorizing Substantial Consummation of the Trustee's Plan; (3) Appointing Directors and Officers; and (4) Providing for Notice (the "Confirmation Order"), a copy of which is attached hereto as Appendix C. On February 25, 1976, the District Court entered its Order in Aid of Substantial Consummation (the "Substantial Consummation Order"), a copy of which

*Here, as elsewhere, emphasis supplied unless otherwise indicated.

BLEED THROUGH

is attached hereto as Appendix D. On or about March 1, 1976, petitioners filed a notice of appeal from the Confirmation Order and the Substantial Consummation Order, and on March 3, 1976, they filed a motion in the Ninth Circuit to stay both orders and all other actions by the District Court. That motion is now pending before the Court of Appeals.

Simply stated, the petitioners have attempted to appeal from each and every order of the District Court, regardless of the effect of any given order on petitioners or the merits of any given appeal. While certain of these orders "substantially determined" some issues in the bankruptcy proceedings, the SEC Submission Order, which did nothing more than submit the Trustee's Plan to the SEC for its advisory report, determined nothing and, therefore, is not appealable.

ARGUMENT.

I.

The Interlocutory Order Involved Herein Was Not an Appealable Order Because It Did Not Substantially Determine Any Issue.

Section 24(a) of the Bankruptcy Act (11 U.S.C. § 47(a)) grants appellate courts jurisdiction over interlocutory orders entered in proceedings in bankruptcy. The appellate courts have uniformly held, however, that only those orders which "substantially determine some issue" are reviewable on appeal. *In re Chicago Rapid Transit Co.*, 200 F.2d 341, 343 (7th Cir. 1953). *See also*, 2 *Collier on Bankruptcy*, ¶ 24.39 (14th ed. 1972).

Petitioners contend that this judicially imposed limitation on the appealability of orders from proceedings in bankruptcy no longer exists, and that "all appeals from proceedings in bankruptcy are *as of right* [emphasis in original]. . . ." (Petition, p. 8.) This argument was made and rejected less than six months ago in *In re Durensky*, 519 F.2d 1024 (5th Cir. 1975), where the court of appeals dismissed an appeal from a district court's order dismissing an appeal of a bankruptcy judge's order denying a motion to dismiss. After determining that "the instant case constitutes a 'proceeding'," the court went on to state:

> "It might appear, therefore, that the district court's order of remand in the instant case—with its concomitant refusal to reverse the bankruptcy judge's denial of the Government's motion to dismiss—would surely be an appealable order in view of our determination that this case is a proceeding in bankruptcy. *Such a sweeping conclu-*

BLEED THROUGH

sion would be ill-advised however, for the courts of appeals have interpreted section 24a so as to allow appeals from interlocutory orders in proceedings only when the orders dispose of some right or duty asserted by one of the parties. See, e.g., City of Fort Lauderdale v. Freeman, 5 Cir. 1952, 197 F.2d 122, 124; *Sherr v. Sierra Trading Corp.,* 10 Cir. 1974, 492 F.2d 971, 975; *In re Charmar Investment Co., supra,* 475 F.2d at 563; *Cope v. Aetna Finance Co.,* 1 Cir. 1969, 412 F.2d 635, 639; *Dubnoff v. Goldstein,* 2 Cir. 1967, 385 F.2d 717, 722; *Carolina Mills v. Corry,* 4 Cir. 1953, 206 F.2d 76, 77; *In re Chicago Rapid Transit Co.,* 7 Cir. 1953, 200 F.2d 341, 342." *Id.* at 1028.

The court went on to explain its reasoning:

> "The obvious explanation for this judicial gloss on the statutory language is that if every word issuing from the bankruptcy judge's mouth or pen were to be a proper subject for immediate review by the district court and the court of appeals, bankruptcy proceedings would cease to offer a reasonably swift resolution of pressing economic difficulties." *Id.*

Thus, to be appealable, an order must determine with "finality [some] substantive issue in dispute. . . ." *Dubnoff v. Goldstein,* 385 F.2d 717, 721 (2nd Cir. 1967). *See also,* 2 *Collier on Bankruptcy,* ¶ 24.39 (14th ed. 1972). The statute does not permit an "appeal . . . [to] be taken from orders relating to mere preliminary or procedural matters." *Carolina Mills, Inc. v. Corry,* 206 F.2d 76, 77 (4th Cir. 1953).

In the instant case, the SEC Submission Order appealed from did not substantially determine any issue and therefore was not a proper subject for appeal under the above authorities. The order appealed from did no more than submit the Trustee's Plan to the SEC for examination and report—a report that itself is advisory only.

In that sense, the SEC Order is closely analogous to bankruptcy court orders which submit matters to a special master for advice. Such orders of reference to a special master uniformly have been held by the courts to be not reviewable. *In Re Hotel Governor Clinton,* 107 F.2d 398, 398-99 (2nd Cir. 1939); *Federal Land Bank of Springfield v. Hansen,* 113 F.2d 82, 84-85 (2nd Cir. 1940). Similarly, all that the District Judge has done in this case is to regard the Trustee's Plan as "worthy of consideration" and follow the mandate of Section 172 of the Bankruptcy Act by submitting the Trustee's Plan to the SEC for its expert advice. Clearly, the SEC Submission Order neither disposed of a "right or duty" asserted by petitioners nor finally determined a "substantive issue in dispute".

In response to the above cited authorities, petitioners do nothing more than attempt to distinguish *In re Chicago Rapid Transit Co., supra,* and *Dubnoff v. Goldstein, supra.* Petitioners conclude by stating that:

> "Judge Pregerson's decision that the Plan was worthy of consideration was a step in the course of these proceedings which determined a substantive issue on the merits." Petition, p. 11.

On page 12 of the Petition, petitioners undertake to describe the "substantive issue" which purportedly was

BLEED THROUGH

decided by the District Court in entering its SEC Submission Order:

> "[I]t certainly affected asserted rights of Appellants because the district court was deeming as 'worthy of consideration' a plan which failed to make any provisions for satisfying Appellants' claims or the claims of those in a similar category. *The Plan is therefore, neither 'fair and equitable' nor 'feasible' as required by Sections 174 and 221(2) of the Bankruptcy Act (11 U.S.C. §§ 174 [sic] and 621(2)) and is certainly not 'worthy of consideration'.*"

Petitioners' own contention belies their assertion that the instant order is subject to appeal, for the District Court's determination that the Plan is "fair and equitable, and feasible" was made pursuant to Section 174 of the Act (11 U.S.C. § 574) when it entered its December 8, 1975 *Approved Order* (App. A-2)—not when it entered the SEC Submission Order.* The petitioners have noticed an appeal from the Approval Order, and that appeal presently is pending before the Ninth Circuit Court of Appeals. Since the very issue which they seek to litigate by this appeal is properly the subject of that appeal, Petitioners were not harmed by dismissal of the instant appeal; for they will have ample opportunity to litigate whether the District Court erred in finding the Trustee's Plan fair and equitable and feasible in their appeal from the Approval Order.

---

*Section 172 of the Bankruptcy Act, unlike Section 174, does not require a finding that a plan be "fair and equitable, and feasible."

What petitioners really seek is to have the same issue determined by the Court of Appeals in *three* separate appeals.* Such duplicative and dilatory efforts should not be condoned—they will benefit no one and will serve only to prolong these already lengthy reorganization proceedings to the detriment of EFCA's creditors.

II.

Petitioners Are Not Aggrieved Parties and Lack Standing to Appeal.

A. Petitioners Are Not Aggrieved Parties.

As the Ninth Circuit held in *Klein v. Rancho Montana de Oro, Inc.*, 263 F.2d 764, 771 (9th Cir. 1959), only an "aggrieved party" may appeal from an order of the Bankruptcy Court. *See*, Section 25 of the Act (11 U.S.C. § 48). Moreover, a party is "aggrieved" only

> "if his property may be diminished, his burden increased, or his rights detrimentally affected by the order sought to be reviewed." 263 F.2d at 771.

As noted *supra*, the SEC Submission Order made no determination of any substantive issue, and hence petitioners cannot be "aggrieved parties" with respect to that order. The SEC Submission Order merely referred the Plan to the SEC for its advice; petitioners' rights were not detrimentally affected in any way.

---

*The appeals from the Approval Order and the Confirmation Order include the issue of whether the Trustee's Plan is fair and equitable and feasible.

BLEED THROUGH

Petitioners argue that the "aggrieved party" limitation imposed by Section 25 of the Act (11 U.S.C. § 48) was displaced by the 1968 amendments to Rules 4(a) and 6 of the Federal Rules of Appellate Procedure. Petitioners cite no authority for this proposition, and, indeed, none can be found. In fact, as recently as 1973 the First Circuit Court of Appeals relied on the precise quote from *Klein* cited above in applying the "aggrieved party" test in a Chapter XI proceeding. *In Re DCA Development Corporation,* 489 F.2d 43, 46, n. 10 (1st Cir. 1973). *See also, Marks v. Brucker,* 434 F.2d 897, 898 (9th Cir. 1970); *Wells v. Dickinson,* 403 F.2d 635 (6th Cir. 1968); 2A *Collier on Bankruptcy,* ¶ 25.08 (14th ed. 1975). Hence, this appeal was properly dismissed because the petitioners are not "aggrieved parties" within the meaning of Section 25 of the Act.

B. Petitioners Have No Valid Claims Against EFCA and Therefore Lack Standing to Prosecute This Appeal.

By Order dated May 1, 1973, the District Court established June 19, 1973 as the bar date for the filing of proofs of claim and provided for the manner of giving notice of such bar date. The proofs of claim of petitioners Danning and Lichtig were not filed until November 25 and December 5, 1974, respectively.*

---

*The original claims of Danning and Lichtig were for $800,000,000 and $750,000,000, respectively. They were subsequently amended to reflect claims of $800,000 and $750,000, but were again amended to restate the initial amounts of $800,000,000 and $750,000,000. In the Petition they are stated to be $800,000,000 and $250,000,000, or a total of $1,050,000,000.

The Trustee timely filed objections* to these claims, and on January 15, 1976, Bankruptcy Judge James E. Moriarty issued his Memorandum and Order sustaining the Trustee's objections to the claims of Lichtig and Danning, copies of which are attached hereto as Appendices E and F, respectively. On January 26, 1976, petitioners filed a notice of appeal to the District Court from Judge Moriarty's Memorandum and Order. That appeal is presently pending before the District Court.

The Trustee's objections to petitioner's claims were based upon the fact that they were filed approximately seventeen months after the bar date, that they are unintelligible and, that in any event, the claims should be equitably subordinated to the claims of EFCA's other creditors because of the claimants' criminal involvement in the operation and financial reporting of EFCA, which involvement ultimately led to their indictment and conviction in *United States of America v. Goldblum, et al.,* Case No. CR 13390-JWC, in the files of the United States District Court for the Central District of California.

---

*Petitioners' assertion that the SEC Submission Order was entered when "there was no objection pending with respect to the Danning and Lichtig claims" (Petition, p. 14) is simply not correct. The Trustee's objections to those claims were filed on June 11, 1975, more than one month prior to entry of the SEC Submission Order.

III.

Conclusion.

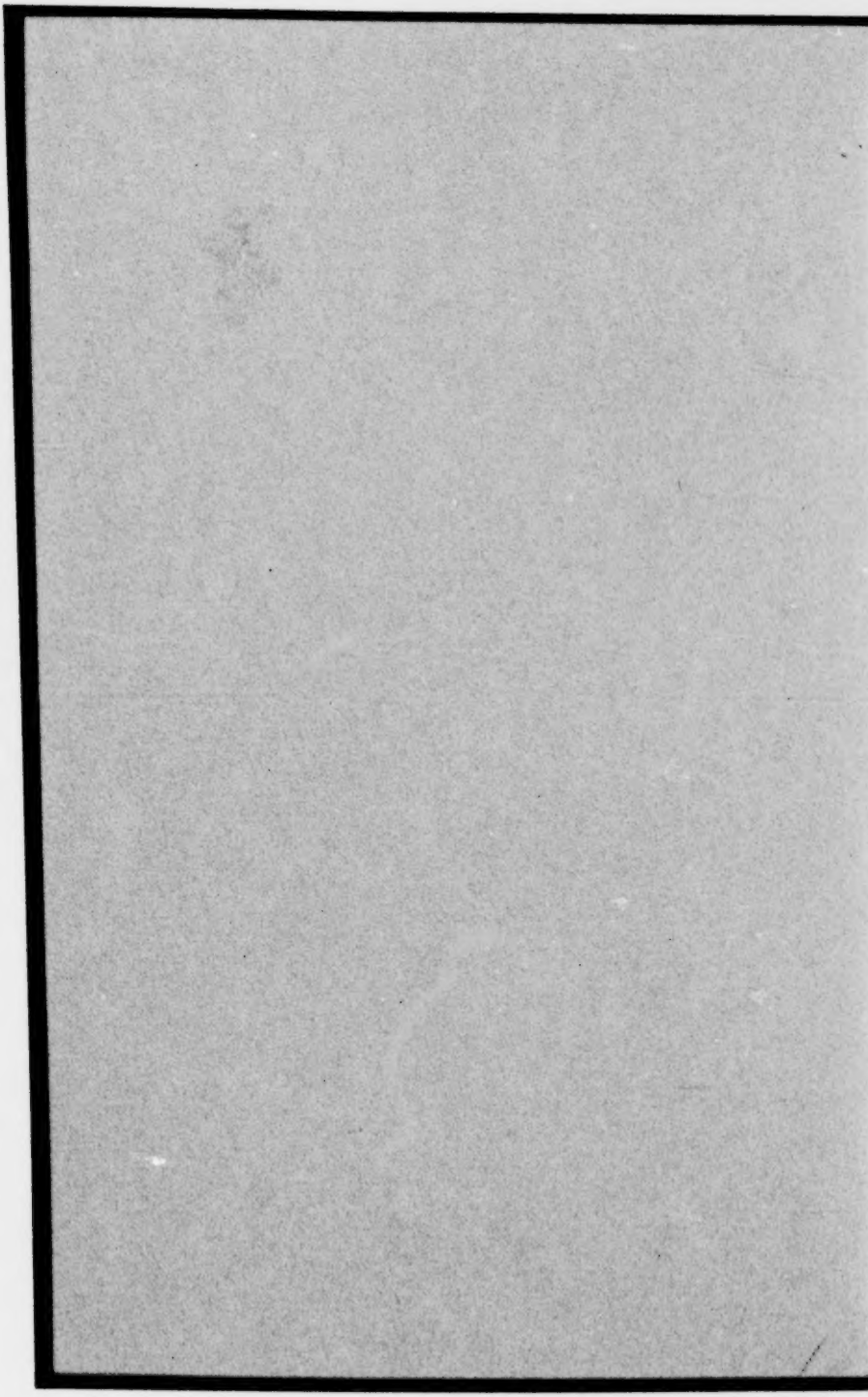
For all of the foregoing reasons, the Petition for a Writ of Certiorari to review the Order of the United States Court of Appeals for the Ninth Circuit below should be denied.

Dated: March 22, 1976.

Respectfully submitted,

EVERETT B. CLARY,
Attorney for Respondent Robert M. Loeffler, Trustee of the Estate of Equity Funding Corporation of America.

Of Counsel:
O'MELVENY & MYERS,
ROBERT J. WHITE.



APPENDIX A.

Memorandum and Order Approving Plan of Reorganization.

United States District Court, Central District of California.

In the Matter of Equity Funding Corporation of America, a Delaware corporation, Debtor.

In Proceedings for the Reorganization of a Corporation. No. 73-03467.

On April 5, 1973, this Court approved the petition of Equity Funding Corporation of America ("EFCA") for protection and reorganization under Chapter X of the Bankruptcy Act (11 U.S.C. § 501, *et seq.*).[1] On October 24, 1974, after soliciting suggestions for a plan pursuant to Section 167(6) of the Bankruptcy Act [11 U.S.C. § 567(6)], Robert M. Loeffler, the duly appointed and acting Trustee of EFCA, filed a proposed Plan for its reorganization.

Pursuant to Section 169 of the Bankruptcy Act (11 U.S.C. § 569), and after due notice to the Debtor, its creditors and stockholders, the Securities and Exchange Commission, the indenture trustees and the Secretary of the Treasury, as required by Section 171

---

[1]On August 1, 1975, procedural rules governing Chapter X proceedings under the Bankruptcy Act became effective. Order Approving Chapter X Rules and Official Forms, 421 U.S. 1021 (1975). These rules apply to pending proceedings unless the Court finds that their application would not be feasible or would work an injustice. 421 U.S. at 1022. Unless otherwise noted, any reference in this Memorandum to a specific section of the Bankruptcy Act is to that section as modified, if at all, by the Chapter X rules.

of the Bankruptcy Act (11 U.S.C. § 571), hearings were held on that proposed Plan commencing December 9, 1974 and continuing from time to time until December 8, 1975. During that period the hearings consumed 28 court days. In the course of the hearings, the proposed Plan has undergone a number of amendments. The final amended Plan is dated December 5, 1975. In this Memorandum the term "Plan" refers to the December 5, 1975 amended version unless otherwise noted. An earlier version, identical in substance to the Plan, has been reviewed by the Securities and Exchange Commission, and its Advisory Report dated November 25, 1975 ("Advisory Report") has been received by the Court. The Advisory Report concludes that the Plan "may be found to be fair and equitable and feasible." The Court has considered that report, as well as all the evidence adduced at the hearings, the memoranda filed by the parties, the arguments of counsel, and the files and records in this entire proceeding. Accordingly, it is now appropriate for the Court to determine whether the Plan should be approved.

The Court finds that the Trustee's Plan complies with Section 216 of the Bankruptcy Act (11 U.S.C. § 616); that the Plan is "fair and equitable, and feasible" within the meaning of Section 174 of the Bankruptcy Act (11 U.S.C. § 574); and that the Plan should be approved. Therefore, pursuant to Section 174 of the Bankruptcy Act (11 U.S.C. § 574), the Court approves the Plan and orders that it be transmitted to the creditors of the estate for their acceptance or rejection, in accordance with the terms of the Orders herein dated December 8, 1975.

BLEED THROUGH

I. BACKGROUND OF EFCA AND OF THE FRAUD

A. *EFCA as of April 5, 1973*

EFCA is a Los Angeles-based holding company. Prior to the filing of the Chapter X petition, its subsidiaries were engaged in a diverse array of businesses. Major subsidiaries included four life insurance companies: Bankers National Life Insurance Company ("Bankers"), chartered in New Jersey and headquartered in Parsippany, New Jersey; Northern Life Insurance Company ("Northern"), chartered in Washington and headquartered in Seattle, Washington; Equity Funding Life Insurance Company ("EFLIC"), chartered in Illinois and headquartered in Los Angeles, California; and Equity Funding Life Insurance Company of New York ("EFNY"), a wholly-owned subsidiary of Bankers chartered and doing business in the state of New York.

EFCA's subsidiaries also included an investment advisory company that managed three mutual funds; a securities and broker-dealer group which licensed EFCA salesmen to sell securities and which had seats on a number of regional stock exchanges; a savings and loan association with three offices in Los Angeles; a foreign financing group organized to obtain Eurodollar and foreign currency borrowings, the leading subsidiary of which was Equity Funding Capital Corporation, N. V. ("NV"), which in turn owned an international merchant bank located in Nassau, Bahamas; and companies engaged in cattle breeding, real estate development, and oil and gas exploration. Other subsidiaries operated a marketing organization consisting

of approximately 130 branch offices throughout the United States, staffed by more than 5,000 licensed salesmen. The salesmen marketed a broad range of financial products and services sponsored by both EFCA and other companies, including the Equity Funding Program, described below; life insurance policies; various mutual fund shares; and limited partnership interests in oil and gas, cattle, and real estate ventures.

The Equity Funding Program had been EFCA's most vigorously marketed product. The company initiated the sale of these programs in 1960, the year it was formed. A participant in the program would undertake: (1) to purchase a life insurance policy and (2) to invest in mutual fund shares over a ten-year period. The program worked in this fashion: The participant would annually purchase and pay for a number of mutual fund shares. EFCA would pay the annual premium on the participant's life insurance policy as it came due, recording each payment as a loan to the participant, and retaining the participant's mutual fund shares as collateral for the loan. Each year, the participant reborrowed the outstanding indebtedness and accrued interest, plus the annual premium on his insurance policy, and a promissory note to EFCA for the amount borrowed was executed. Each year the participant had to purchase sufficient mutual fund shares to satisfy the collateral requirements for his note. These programs were sold with the expectation that the mutual fund shares which the participant purchased would increase in value during the life of the program in an amount equal to or greater than the total cost of the life insurance premiums and the accrued interest.

BLEED THROUGH

EFCA received commissions from the sale of both the mutual fund shares and the insurance policies it sold to the program participants, and it also received interest on the money it loaned to those participants to pay their insurance premiums. Moreover, sales of Equity Funding Programs could generate income for EFCA from two other sources. If the insurance policy sold was issued by a subsidiary of EFCA, that subsidiary could expect to earn a profit during the time the policy was kept in force. And, if the mutual fund shares were issued by a fund managed by an EFCA subsidiary, the management fees paid by the fund to that subsidiary increased.

By early 1973, EFCA and its subsidiaries maintained more than 200,000 public customer accounts. These public customers included Equity Funding Program participants, life insurance policyholders, participants in programs to purchase mutual funds, and limited partners of EFCA-sponsored partnerships. Not a single public customer has been damaged by these Chapter X proceedings or by the events that gave rise to them, with the exception of some of the participants in funding programs sold before 1963; these customers are provided for in the Plan.

When the Chapter X petition was filed, EFCA had outstanding 7,835,127 shares of common stock. The stock was listed on the New York Stock Exchange and in 1969 had traded as high as 92½. At the close of business on March 16, 1973, immediately before rumors of the EFCA fraud began to affect the market, the stock traded at 25 3/8. By March 27, 1973, when trading was suspended, the stock had declined to 14 3/8. The stockholders' interest in EFCA,

as such, was without value due to its insolvency. But under the Plan, the EFCA stockholders will realize substantial recoveries as "fraud claimants" (*see* Part V D *infra*).

EFCA's total scheduled debt as of April 5, 1973, exclusive of trade creditors, was $204,564,609, as follows:

Debt Holder		Date	Amount
SECURED			
Revolving Credit Agreement (before set offs)[2]		06-29-72	$ 50,535,688
First National City Bank	23,583,321		
Wells Fargo Bank	10,107,137		
Franklin National Bank	10,107,138		
National Bank of North America	6,738,092		
Wells Fargo Bank		06-29-72	309,375
Various individuals		07-14-72	158,967
Israel Discount Bank & Bankers Trust Co.[3]		01-28-71	5,105,000
			$ 56,109,030
CUSTODIAL COLLATERAL NOTES[4]			
Pennsylvania Life		Various	$ 5,814,753
State Farm		Various	2,250,000
Cosmos Bank[5]		06-22-71	1,200,000[6]
National Bank of North America		03-27-72	5,000,000
National Newark & Essex Bank		05-01-72	5,000,000
First National City Bank		06-01-72	5,000,000
Wells Fargo Bank		06-15-72	5,000,000
American National Bank & Trust Co.		07-10-72	5,000,000
United California Bank		09-15-72	5,000,000
Seattle First National Bank		11-01-72	1,000,000
			40,264,753

[2]Secured by 100% of the stock of Bankers and Northern and 60% of the stock of EFLIC. The validity of the security interest in Bankers and Northern is disputed.

[3]Secured by 40% of the stock of EFLIC, which is being liquidated (*see* note 9 *infra*).

BLEED THROUGH

Debt Holder	Date	Amount
UNSECURED		
9½% Debentures[7]	12-01-70	22,000,000
Dow Banking Corporation[5, 8]	12-23-71	6,192,000[6]
Dow Banking Corporation[5]	02-17-72	5,944,000[6]
BancOhio Corporation	06-29-72	8,000,000
Nash Agency	12-01-72	183,440
Realty Insurance Associates	12-06-72	190,386
Cosmos Bank[5]	06-22-71	39,000[6]
		42,548,826
SUBORDINATED		
5¼% Debentures[5,7]	02-01-69	23,872,000
7½% Subordinated Notes[5]	11-15-69	3,270,000
5½% Debentures[7]	12-01-71	38,500,000
		65,642,000
TOTAL		$204,564,609

While EFCA's published financial statements reported substantial stockholders' equity, the assets reported in those statements were grossly inflated. The investigation conducted by the Trustee revealed that as of April 5, 1973, EFCA's real assets totaled but $158,656,510 on an unconsolidated basis. Thus, EFCA was hopelessly insolvent based upon scheduled debt alone.

---

[4]These notes represent funds EFCA borrowed to finance Equity Funding Programs. They are secured by notes from Equity Funding Program participants, which in turn are secured by the participants' mutual fund shares. The adequacy of the security is disputed in relatively minor respects, and the dispute has been settled by an agreement approved by the Court.

[5]Issued by NV and guaranteed by EFCA.

[6]Three loans to NV are payable in Swiss Francs. The amounts shown are based on an exchange rate in effect on April 5, 1973.

[7]Publicly issued debentures.

[8]Certain assets of EFCA were pledged to secure the guarantee. A dispute over the validity of the pledge has been compromised under an agreement approved by the Court.

In addition, EFCA was subject to contingent claims based on fraud and on violations of the Securities Act of 1933 (15 U.S.C. §§ 77a, *et seq.*) and the Securities Exchange Act of 1934 (15 U.S.C. §§ 78a, *et seq.*) ("Securities Acts").

B. *The Equity Funding Fraud*

A trustee under Chapter X is mandated by Sections 167(1) and (3) of the Bankruptcy Act [11 U.S.C. §§ 567(1) and (3)] to file two reports, one relating to the property, financial condition, and operation of the business of the debtor, and other matters bearing upon the possibility of reorganization; and the second relating to fraud, misconduct, mismanagement, and causes of action available to the estate. These reports were filed by the Trustee on February 22 and October 31, 1974. The nature and extent of the fraud revealed by those reports is important to an understanding of the legal and factual problems dealt with in the Plan.

In essence, the Trustee concluded that EFCA had falsified financial records beginning at least as early as 1964 and continuing until the date the petition was filed. The falsification primarily consisted of inflating or creating assets and income, failing to record liabilities, and creating bogus insurance policies, which were then coinsured. The Trustee reported that, contrary to its publicly issued financial reports, EFCA was probably never profitable. During the period 1964 through 1972, at least $143 million in fictitious pre-tax income and fictitious assets in a corresponding amount were recorded in the Company's financial statements. Approximately $85 million of this total represented inflated receivables attributed to the Equity Funding Program.

BLEED THROUGH

Following the completion of an audit by Touche Ross & Co., the Court-appointed auditors, more than $143 million of fictitious or fraudulently inflated assets were eliminated from EFCA's books, and more than $42 million of assets were written down to reflect more realistic values. As a result, on EFCA's balance sheet, unconsolidated assets were written down from $344.2 million to $158.6 million, and stockholders' equity went from $143.4 million to a deficit of $42.1 million.

These facts have given rise to the filing of more than 100 federal court actions against EFCA, its subsidiaries and others, by or on behalf of present and former holders of EFCA debt and equity securities, in which the plaintiffs claim damages for fraud and violation of the Securities Acts. These actions have been coordinated and consolidated in the Central District of California by the Judicial Panel on Multi-District Litigation [*In re Equity Funding Corporation of America Securities Litigation*, M.D.L. Docket No. 142 (C.D. Cal.)] ("Multi-District Actions"), but are stayed by this Court so far as EFCA and its subsidiaries are concerned. *See In re Equity Funding Corp. of America*, 396 F. Supp. 1266 (C.D. Cal. 1975). Similar fraud and Securities Acts violations have been asserted in these Chapter X proceedings on behalf of the same holders of EFCA debt and equity securities.

II. THE REORGANIZED COMPANY

When EFCA's true financial condition was uncovered, it became apparent that the principal income-producing assets were Bankers and Northern, and that

EFCA would have to be reorganized around them if it were to be reorganized at all. Accordingly, the Trustee, with the approval of the Court, sold or liquidated subsidiaries that were insolvent, were losing operations, required infusions of unavailable cash, or could not provide support for the contemplated insurance operation. EFLIC, which was insolvent, was taken over by the Insurance Department of the State of Illinois, and placed in liquidation. Those liquidation proceedings, which are now nearly concluded,[9] provide for the complete protection of EFLIC policyholders through the assumption of all existing policies by Northern.

Sales of the Equity Funding Program were suspended upon disclosure of the EFCA fraud, because that disclosure rendered ineffective the Prospectus under which the program had been sold. No attempt has been or will be made to resume sales of these programs. Their sales appeal has been substantially impaired by rising interest rates and uncertain stock market conditions. In addition, the Trustee's investigation into EFCA's business affairs disclosed that the cost of ad-

---

[9]A Plan of Liquidation has been approved by the Circuit Court of Du Page County, Illinois. *In re People ex rel. Robert B. Wilcox v. Equity Funding Life Insurance Co.,* Case No. 73 1019 G, and the order of approval has been affirmed by the Supreme Court of the State of Illinois. 338 N.E. 2d 448 (Ill. 1975). In addition, this Court approved an agreement between the Trustee and the Conservator of EFLIC governing the Trustee's participation in the liquidation proceedings. That ruling was affirmed by the Court of Appeals in *Equity Funding Corp. of America v. Loeffler,* 519 F.2d 1274 (9th Cir. 1975). The time to petition to the Supreme Court of the United States for a writ of certiorari to review the Ninth Circuit affirmance has expired; with respect to the decision of the Illinois Supreme Court, that time expires on December 26, 1975.

BLEED THROUGH

ministering the programs exceeded the revenues derived from them. The marketing organization, which handled products and services including the Equity Funding Program, has been reorganized by eliminating unproductive branches and by converting the productive branch offices into general agencies of Bankers and Northern.

Moreover, existing Equity Funding Programs are being liquidated. In the liquidation process, the rights of individual program participants are protected. A participant may either pay the amount due on his note and receive delivery of his mutual fund shares, or his mutual fund shares, which secure his note, will be sold. In the latter case, the secured note will be paid from the proceeds of sale and any remaining equity will be delivered to the participant.

As a result of these sales and liquidations, the businesses that now remain are Bankers and Northern, a portion of the securities and broker-dealer group which licenses life insurance agents of Bankers and Northern to sell securities, the cattle group which will be sold as soon as favorable market conditions permit, and other minor operations that are in process of sale or liquidation. Under the Plan, these assets will be placed in a holding company, which may be a newly-formed corporation or a recapitalized EFCA (for convenience, this Memorandum will hereafter refer to the entity as the "New Company"). Whether New Company is a new corporation or a recapitalization of EFCA will not change the substance of the Plan. The Plan also provides for initial working capital for New Company of at least $2 million.

The use of a holding company to control the operating insurance subsidiaries will add flexibility to New Company. Restrictions applicable to the operation of life insurance subsidiaries will not apply to the holding company. The holding company structure will not significantly increase operating costs. Other than debt service, New Company's expenses will consist only of salaries for its chief executive officer and a small staff, all of whom may also serve as employees of either Bankers or Northern, or both; rent for a small headquarters office; and fees for limited accounting services. The Plan does not affect the operating businesses of Bankers and Northern, nor does it affect the ability of Bankers and Northern to protect their policyholders.

The Plan can be substantially consummated and New Company can commence business before the Trustee has completed certain administrative details which are unrelated to the launching of New Company, including prosecution of pending litigation on behalf of the estate. Thus, when New Company starts business, the Plan envisions the Trustee's retention of sufficient cash to finance his administration to its conclusion. Thereafter, any cash on hand beyond the needs of the estate will be turned over to New Company as a capital contribution.

The reorganized company, whatever its configuration, could not carry EFCA's debt burden. As previously noted, total scheduled debt as of April 5, 1973 was more than $200 million. That amount has since been reduced to approximately $160 million (exclusive of post-petition interest and fees) primarily in two ways:

(a) Creditors of NV, whose debts EFCA had guaranteed, were partially paid from the liquida-

BLEED THROUGH

tion of NV and from certain EFCA assets in which some of NV's creditors claimed a security interest, a claim that has been compromised with the approval of the Court.

(b) The claims of the lenders that had financed the Equity Funding Program have been compromised, pursuant to an agreement approved by the Court. Under the compromise, the money received from payment of the participants' notes (see p. 8[11] *supra*) will be paid to the lenders and to the debtor estate on agreed-upon terms, and, as a consequence, the debtor estate will receive approximately $5.4 million. The lenders will retain a general unsecured claim against the estate for certain pre-petition interest charges in the approximate amount of $550,000, and the custodian bank that held the security will retain a general unsecured claim of $1 million.

Under the Plan, all the remaining debt will be discharged by issuance of one class of voting common stock of New Company, except for (1) certain priority and other claims, all in relatively minor amounts, which will be paid in cash and (2) the debt incurred under the Revolving Credit Agreement.

As of April 3, 1973, the debt owed to the group of banks led by First National City Bank under the Revolving Credit Agreement totaled $50,535,688.19. As previously stated, the loan was secured by a pledge of all the stock of Bankers and Northern (subject to certain disputes to be discussed later) and 60% of the stock of EFLIC. On April 3, 1973, these banks declared the loan in default, and offset EFCA's bank deposits of $7,953,719.14, leaving a balance of

$42,581,969.05. Interest and fees under the Revolving Credit Agreement from April 5, 1973 to March 31, 1976 total approximately $15,600,000, and would be recoverable from the security, if the loan were fully secured.

Under the Plan these items are to be discharged in the following manner: The lending banks will be permitted to retain the sum of $7,953,719.14, which they offset on April 3, 1973. They will waive all interest and fees that have accrued under the Revolving Credit Agreement since April 5, 1973. They will be paid the sum of $15 million in cash or in New Company's Senior Secured Notes. It is anticipated that this $15 million payment will be made $7 million in cash and $8 million in Senior Secured Notes, assuming the cattle group is not sold by the time New Company is launched. Proceeds from the sale of the cattle group, when sold, will be applied against the Senior Secured Notes. It is estimated that the cattle group can be sold for approximately $5 million within two years. In addition to this $15 million payment, the lending banks will be issued another series of New Company's notes called Senior Secured Income Notes in the amount of $27,581,969.05.

Five million dollars of the Senior Secured Notes mature eight years from date of issuance, and the balance mature in five years. The notes bear interest at 2% above First National City Bank's prime rate, except that, upon the sale of certain assets, up to $1,280,000 of these notes bear interest at ¼% above that bank's prime rate but in no case more than 7%. These notes have been valued at their face amount, because, in general, the borrowing terms are standard.

BLEED THROUGH

The Senior Secured Income Notes are 12-year notes, amortizable in the third through twelfth years as to principal. They contain provision for deferral of payments of principal, if earnings of New Company fail to reach prescribed levels. They bear interest at ¼% above First National City Bank's prime rate, but in no case more than 7%. Payment of interest for the first two years may be deferred and amortized over the succeeding five years without any penalty or additional charge. Because of these terms, the fair market value of these notes is $19,847,000 compared to their face amount of $27,581,969.05.

As previously noted, under the Plan all other claims, with minor exceptions, will be discharged by issuance of voting stock in New Company. Subject to Court approval, the initial directors and officers of New Company will be appointed by the Trustee. Thereafter, the directors will be elected by the stockholders and the directors, in turn, will elect officers in the usual manner. To this end, the Plan requires the convening of a stockholders' meeting within six months after the end of New Company's first fiscal year, which is now expected to be December 31, 1976.

The Plan provides for discharge of all claims not recognized in the Plan and for court orders permanently enjoining and dismissing all actions against EFCA's subsidiaries based on EFCA's fraud.

III. THE PLAN IS FEASIBLE

Section 174 of the Bankruptcy Act (11 U.S.C. § 574) requires, among other things, that a plan of reorganization be feasible. This means that the Plan must propose a business entity that has assets capable

of producing sufficient income to assure its long-term viability and to service its debt. 6A W. Collier, Bankruptcy, ¶ 11.07, at 637-44 (14th ed. 1972).

A finding of feasibility requires the Court to consider, among other things, a projection of the income of the reorganized company. In this case, New Company's principal income-producing assets—Bankers and Northern—present sui generis problems of projecting earnings. The method normally used to project earnings of a business organization focuses on the following elements: (1) past earnings reports and (2) future sales and expense assumptions. *Protective Committee v. Anderson*, 390 U.S. 414, 441-53 (1968); *Consolidated Rock Products Co. v. Du Bois*, 312 U.S. 510, 526 (1941). This method of projecting earnings would be used unless special factors make it an unreliable guide to future earning expectancy (*Protective Committee v. Anderson, supra* at 452). Such special factors exist in this case.

As life insurance companies, Bankers and Northern historically reported their earnings on the basis of statutory accounting, a method of accounting prescribed by state insurance departments. While sufficient for regulatory purposes, such as measuring the solvency of a life insurance company to insure protection of policyholders, past earnings reported under this method of accounting may not be the most reliable guide to future earnings and can be misleading to public investors for two reasons. First, a life insurance company expends a substantial sum to sell a policy and to place it on the company's books. Statutory accounting requires the company to charge this one-time payment as an expense in the first year of the policy, rather

BLEED THROUGH

than spreading it over the life of the policy. Second, statutory accounting requires the build-up of reserves for new policies at a rate that is higher than experience generally proves necessary. For these two reasons, a company that is writing large amounts of new life insurance business may show low earnings, or even losses, although the new business will produce large income over the life of the new policies written. By comparison, a company that is writing no new business may show large profits from policies written in earlier years, even though such a company is, in effect, going out of business. Past statutory earnings of Bankers and Northern are particularly unreliable indicators of future earning expectancy because both companies have substantially increased their new business production and have made significant changes in the nature of their operations and types of insurance sold during the administration of the estate.

Recognizing the need for a more accurate determination of annual earning capability, the American Institute of Certified Public Accountants has developed an Audit Guide for the preparation of financial statements of stock life insurance companies based upon generally accepted accounting principles ("GAAP"). This guide is to be used for all financial statements issued to public investors after January 1, 1974. Under GAAP, expenses are allocated more evenly over the life of the policies a company writes, and policy reserves are established on realistic bases. Thus, GAAP earnings reports do not have the characteristics of statutory reports mentioned above. Although some stock life insurance companies have reported or restated prior earnings on GAAP, Northern had no audited financial

statements prepared on GAAP, and the existing Bankers GAAP financial statements were prepared on the basis of a prior tentative draft of the Audit Guide. Thus, neither company had past earnings data which could be used for making realistic future income projections.

For the reasons stated above, a more reliable way to predict future earnings of a life insurance company is to analyze the following elements: its in-force business, its forecasted future sales of new policies, and its income from assets not attributed to policy reserves. This was done for both Northern[10] and Bankers. The Court heard expert testimony for this purpose, and, by methods used and generally accepted in the life insurance industry, 10 year projections of future earnings were made, both on statutory and GAAP bases. Since earnings of life insurance companies cannot be consolidated with those of a parent or affiliated company for tax purposes,[11] these earnings projections were adjusted for taxes.

A life insurance company is permitted by law to pay ordinary dividends only on the basis of its statutory income. Thus, the projected statutory income of Bankers and Northern is critical to a determination of feasibility, because dividend income from Bankers and Northern will be the principal source of funds to New Company

---

[10]The future earnings of Northern's in-force business included the projected earnings from valid life insurance policies of EFLIC which are to be assumed by Northern pursuant to the EFLIC Plan of Liquidation. This was done on the assumption that the EFLIC Plan of Liquidation will be finally approved before the consummation of this Plan. *See* note 9 *supra*.

[11]A life insurance company must file its own tax return. The parent, in turn, pays no taxes on the earnings of or dividends received from the subsidiary insurance company.

BLEED THROUGH

for the payment of the Senior Secured Income Notes and, perhaps, for payment of a part of the Senior Secured Notes. Modest amounts of additional income may be realized from the securities group and from interest earned from funds on hand. Appendix I shows the projected cash flow of New Company from these sources and all items of expense, including debt service. As Appendix I demonstrates, cash flow will be adequate to service debt.[12]

So long as cash flow is adequate to cover required debt service, the more significant projection from the investor's point of view is that of GAAP earnings. Appendix II shows the projected consolidated earnings of New Company on that basis.

It should be observed that, under the Senior Secured Income Note Agreement, New Company's obligation to amortize the Income Notes generally is limited to 50% of the combined statutory earnings of Bankers and Northern for the prior year. Moreover, the cash flow analysis in Appendix I demonstrates that 50% of the statutory earnings is sufficient for servicing not only the Senior Secured Income Notes, but the Senior Secured Notes as well. Thus, fully one-half of the earnings of the insurance companies is available for reinvestment, for meeting unexpected financial problems, or for paying dividends to the stockholders of New Company.

On the basis of these data, the Court finds that the Plan is feasible.

---

[12]Appendix I does not include the projected results of operations of the cattle group. It is expected that the group will carry itself until sold.

IV. VALUATION

It is necessary to value assets to be transferred to New Company for three purposes. *See* 6A W. Collier, *supra* ¶ 11.05, at 588. First, the lending banks under the Revolving Credit Agreement claim as security the stock of Bankers and Northern; therefore, the value of this security must be determined. Second, the plan makes no provision for stockholders as such; therefore, it can be approved only if EFCA is insolvent, *i.e.*, the claims of creditors exceed the value of its assets. Third, the creditors who are paid in New Company stock need to evaluate the economic effect of the Plan; therefore the value of New Company must be determined.

For all three purposes, the Court is required to determine the "reorganization value" of New Company. *Consolidated Rock Products Co. v. Du Bois, supra.* The reorganization value of an ongoing business is the present value of the future earning capacity of the business. *Protective Committee v. Anderson, supra* at 441-42; *Consolidated Rock Products Co. v. Du Bois, supra* at 526. Future earnings are normally based on past earnings reports. However, for the reasons stated in Part III, the feasibility section of this Memorandum, the future earnings of Northern and Bankers were developed from the heretofore mentioned analysis of their in-force business, their future sales capability, and their income from assets not attributed to policy reserves.

Each segment of future earnings was then discounted or capitalized to arrive at the present value of the

future earning capacities of Bankers and Northern, as follows:

> (a) The value of each company's existing business was determined by projecting profit flow from that business for 30 years and then discounting to present value at 15%.
>
> (b) The value of each company's future sales capability was determined by capitalizing at five times the present value of the future profits from one year's production of business.
>
> (c) The value of the assets not attributed to policy reserves was determined by adjusting these assets to their market value. These assets are stocks, bonds, mortgages and/or other investments that have a readily determinable market value. That market value is the appropriate measure of their value for reorganization purposes, since the value determined by investors in the marketplace is the best indicator of the present value of the future earnings of the assets. *See Central States Electric Corp. v. Austrian*, 183 F.2d 879, 884-85 (4th Cir. 1950), *cert. denied*, 340 U.S. 917 (1951); *In re Warren Bros. Co.*, 39 F. Supp. 381, 385 (D. Mass. 1941).

The Court finds that this method of determining the present value of future earning capacity adequately recognizes relevant risks and market factors and is fair and reasonable.

These values were determined as of December 31, 1973. The projected after-tax GAAP earnings from January 1, 1974, to March 31, 1976, were then added to these values to determine reorganization value as

of March 31, 1976. That value, as so determined, is $54,315,000 for Northern and $51,121,000 for Bankers. The value of Northern includes the value of the in-force policies of EFLIC, which are to be assumed by Northern pursuant to the EFLIC Plan of Liquidation.[13]

The two other business activities to be transferred to New Company—the cattle group and the securities and broker-dealer group—were valued by estimating the market value of their constituent assets, because neither has an earning history and because the cattle group is to be sold. *See* 6A W. Collier, *supra*, ¶ 11.05, at 604. The value of the securities and broker-dealer group is simply the value of its marketable securities and cash, totaling $1,575,000. The cattle group has two principal assets—cattle and land—from which, based on appraisals of the land and cattle after adjustment for other factors, it is projected that $5,500,000 net will be realized upon ultimate disposition. Miscellaneous noncontingent assets of $671,000 and $2 million cash for start-up working capital will also be transferred to New Company. Thus, the total reorganization value of New Company's assets at the projected transfer date of March 31, 1976 will be $115,182,000

As noted above, New Company will start business with debt consisting of Senior Secured Notes in the face amount of approximately $8 million and Senior Secured Income Notes in the face amount of $27,581,-969.05, but having a present value of $19,847,000. Thus, the reorganization value of the common stock of New Company will be $87,275,000. Based on the

[13] *See* notes 9 and 10 *supra*.

number of shares estimated to be issued under the Plan, the reorganization value per share would be $11.02.[14] A recapitulation of the reorganization value of the assets and securities of New Company is set forth in Appendix III to this Memorandum.

Reorganization value represents the best estimate of value the marketplace would put on a company comparable to New Company. However, because of uncertainties associated with a company emerging from Chapter X proceedings, possible initial selling pressure, and perhaps other factors, individual shares of stock of New Company may trade in the near future at less than reorganization value.

V. THE PLAN IS FAIR AND EQUITABLE

Section 174 of the Bankruptcy Act (11 U.S.C. § 574) also requires that a plan of reorganization be fair and equitable. This means that the distributions to creditors provided for in the Plan must satisfy the "absolute priority rule." This rule requires that creditors be grouped into classes which are then ranked in order of priority, and that no class receive anything of value until senior classes have received full compensation for the value of their claims. *Protective Committee v. Anderson*, 390 U.S. 414, 441 (1968); *Marine Harbor Properties, Inc. v. Manufacturers Trust Co.*, 317 U.S.

[14]The Advisory Report correctly notes at page 16 that, since $500,000 will be reserved for distribution in lieu of small distributions of shares, the more accurate computation produces a number of $11.083. However, as that report also points out at page 45, these numbers are necessarily approximations and their significance is in their order of magnitude rather than their exact amount. For this reason, this Memorandum will use the data introduced into evidence, which produce the $11.02 figure.

78, 85 (1942); *Consolidated Rock Products Co. v. Du Bois*, 312 U.S. 510, 527 (1941); *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 115-19 (1939); *see generally* 6A W. Collier, *supra* ¶ 11.06. Thus, for example, creditors who hold a security interest in assets of the debtor should rank ahead of all other creditors with respect to those assets. Following secured creditors, the general unsecured creditors are entitled to payment in full before anything may be allocated to other creditors whose claims may be subordinated by express agreement or otherwise. Finally, after all creditors are paid, and only then, may provision be made for stockholders. Thus, where, as here, the debtor is insolvent, stockholders receive nothing as stockholders.

While these principles are simple in the abstract, their application in this case is difficult and complex. This is so because there are disputed issues of fact and law with respect to the relative ranking of various classes of EFCA's creditors. Where disputes exist the court has the power to approve a plan of reorganization which compromises the disputes by making provision for each such class in an amount that falls within the reasonable range of litigation possibilities. *Protective Committee v. Anderson*, 390 U.S. 414, 424 (1968); *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 115-19 (1939); *In re Associated Gas & Electric Co.*, 61 F.Supp. 11 (S.D.N.Y. 1944), *aff'd*, 149 F.2d 996 (2d Cir.), *cert. denied*, 326 U.S. 736 (1945); *In re Midland United Co.*, 58 F.Supp. 667 (D. Del. 1944). The test the court should apply in determining whether to approve a compromise plan is the same as that applied to any form of compromise presented

BLEED THROUGH

to a court of bankruptcy, namely, is the compromise fair and equitable?

Protective Committee v. Anderson, supra, sets forth guidelines for determining whether a proposed compromise is fair and equitable:

> "In administering reorganization proceedings in an economical and practical manner it will often be wise to arrange the settlement of claims as to which there are substantial and reasonable doubts. . . . it is essential that every important determination in reorganization proceedings receive the 'informed, independent judgment' of the bankruptcy court. . . . The requirements of §§ 174 and 221(2) of Chapter X, . . . that plans of reorganization be both 'fair and equitable', apply to compromises just as to other aspects of reorganizations. . . . The fact that courts do not ordinarily scrutinize the merits of compromises involved in suits between individual litigants cannot affect the duty of a bankruptcy court to determine that a proposed compromise forming part of a reorganization plan is fair and equitable. . . . There can be no informed and independent judgment as to whether a proposed compromise is fair and equitable until the bankruptcy judge has apprised himself of all facts necessary for an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigated. Further, the judge should form an educated estimate of the complexity, expense, and likely duration of such litigation, the possible difficulties of collecting on any judgment which might be obtained, and all other factors relevant to a full and fair assess-

> ment of the wisdom of the proposed compromise. Basic to this process in every instance, of course, is the need to compare the terms of the compromise with the likely rewards of litigation." 390 U.S. at 424-25. (citations omitted).

While the court must apprise itself of the probabilities of ultimate success should disputed issues be litigated, it is not the duty of the court to determine those issues, for that would render compromise useless. This sensible view is explicated in *Florida Trailer & Equipment Co. v. Deal*, 284 F.2d 567 (5th Cir. 1960):

> "Of course, the approval of a proposed settlement does not depend on establishing as a matter of legal certainty that the subject claim or counterclaim is or is not worthless or valuable. The probable outcome in the event of litigation, the relative advantages and disadvantages are, of course, relevant factors for valuation. But the very uncertainties of outcome in litigation, as well as the avoidance of wasteful litigation and expense, lay behind the Congressional infusion of a power to compromise. This is a recognition of the policy of the law generally to encourage settlements. This could hardly be achieved if the test on hearing for approval meant establishing success or failure to a certainty." 284 F.2d at 571.

In these proceedings, the Court has been fully informed on the disputed issues of fact and law and on the evidence and authorities bearing thereon.

Wherever appropriate, the Trustee has made a thorough investigation of the facts applicable to these disputed issues and has made the results of that investigation available to all counsel as well as to the Court. The investigation included numerous informal interviews and depositions. The Trustee and counsel for interested parties have filed detailed memoranda setting out the pertinent facts and the evidence bearing on any disputed factual issue. Numerous memoranda have also been filed with the Court by both the Trustee and interested parties, bearing on the disputed issues of law. Short of conducting a full trial on the merits, little more could have been done to inform the Court of these disputed issues and of the evidence, facts, and law bearing on their resolution.

Compromise of these disputes is desirable because litigation creates a substantial risk of depleting the assets of the debtor estate. Trial of these complex factual disputes would consume many weeks or months of court time and, because the legal issues are novel, would inevitably lead to appeals to the Ninth Circuit and probably to the Supreme Court. Thus, the delay in litigating these issues would be immense. The principal assets of the debtor estate consist of Bankers and Northern, both going businesses that rely on skilled and qualified personnel within the organization and on agents throughout the country who sell their life insurance policies. These companies have retained most of their personnel and their agents despite these proceedings due to the prospect of reorganization at an early date. Should that prospect be clouded by protracted litigation, these relationships could be impaired or lost, to the irreparable detriment of the debtor estate.

Moreover, the Court has heard testimony and reviewed extensive memoranda suggesting how particular resolutions of each of the issues would affect the distribution that would be made to the various classes of creditors. As a result, the Court has an informed and objective opinion of the probable ultimate results if all these issues were litigated. The Court concludes that the issues are uncertain of resolution, that they are appropriate matters for compromise, and that the Plan's provisions give consideration to risks of litigation. Each affected class will receive, under the Plan, more than it would recover should the issues be decided adversely to that class, and less than it would receive should those issues be decided favorably to it. In each case, the distribution is well within the range of litigation possibilities.

Therefore, the Court finds that the Plan's intended distributions to the respective creditor classes satisfy the absolute priority rule through the compromises set forth in the Plan, are fair and equitable, are in the best interests of the debtor estate and its creditors, and constitute a fair and reasonable compromise of disputed issues of fact and law.

Pursuant to Section 197 of the Bankruptcy Act (11 U.S.C. § 597), the Plan divides the creditors into classes "according to the nature of their respective claims," as follows:

Class 1 — Tax Creditors

Class 2 — Wage Claimants

Class 3 — Secured Lessors

Class 4 — Secured Creditors — Revolving Credit Agreement

BLEED THROUGH

Class 4.1 — Secured Creditors—Bankers Trust Company and Israel Discount Bank

Class 5 — Bankers Rescission Claimants

Class 6 — General Unsecured Unsubordinated Creditors

Class 6.1 — General Unsecured Unsubordinated Creditors—Small Trade Creditors

Class 7 — Holders of Subordinated Debt Instruments

Class 8 — Fraud Claimants

Class 9 — Equitably Subordinated Claims.

The provisions in the Plan concerning four of the classes are not a subject of dispute and can be disposed of quickly. These classes, and the amount of each of their claims, are as follows:

Class 1 — Tax Creditors	$250,000.00
Class 2 — Wage Claimants	2,000.00
Class 3 — Secured Lessors	53,167.58
Class 6.1 — Small Trade Creditors	106,500.00

Classes 1, 2, 3, and 6.1 will be paid in cash in full. Section 271 of the Bankruptcy Act (11 U.S.C. § 671) requires priority payments to Class 1. Because the amount is small, wage claimants in Class 2 are given priority even though Section 64(a) of the Bankruptcy Act [11 U.S.C. § 104(a)] is not applicable to Chapter X. [Bankruptcy Act § 102 (11 U.S.C. § 502)]. There is but one creditor in Class 3, a lessor who holds a certificate of deposit for $53,167.58 to secure performance of EFCA's head office lease. The Trustee rejected the lease, and the lessor is entitled to retain the deposit in partial compensation for damages. Full payment of small trade creditors, Class

6.1, is justified as a matter of administrative convenience.

Creditors in Class 9 are those whom the Court determines, in appropriate proceedings herein, are not entitled on equitable principles to participate on a parity with any of the other classes of creditors. Because the assets are insufficient to satisfy the claims of the other classes, creditors in Class 9 will receive nothing.

Numerous issues and sub-issues of fact and law govern the ranking of the remaining classes of creditors. This Memorandum would be unduly protracted if the Court were to catalog the many legal authorities and evidentiary matters that bear on these issues. Accordingly, this Memorandum will set forth the issues, the contentions that can reasonably be made with respect to them, and the effect which an adverse or favorable resolution of those issues would have on the distribution to the affected creditor classes. While this Memorandum will not cite the authorities which support the various legal contentions, the Court notes that there is substantial authority, cited in counsels' briefs, for all of them, and that these disputed issues are legitimate subjects for debate.

A. *Creditors Class 4—Secured Creditors—Revolving Credit Agreement*

Creditors in Class 4 consist of the banks that loaned money to EFCA pursuant to the Revolving Credit Agreement dated June 29, 1972. Under that agreement, the loans were to be secured by the pledge of all the stock of Bankers and Northern plus 60% of EFLIC's stock. If these Class 4 banks were fully secured, they would be entitled to recover $66.1 million as of March 31, 1976. This $66.1 million figure (which would

BLEED THROUGH

be recoverable out of the security, if adequate) represents $50.5 million—the amount of debt before the April 3, 1973 offests of EFCA's deposits—plus post-petition interest and fees of $15.6 million. The Plan provides for recovery by the Class 4 banks of cash and notes having a reasonable value of $42.8 million, which constitutes 64.8% of their maximum possible recovery. This contemplated recovery consists of:

Offsets of EFCA's April 3, 1973 Deposits..	$ 7,953,719.14
Senior Secured Notes or Cash.....	15,000,000.00
Value of Senior Secured Income Notes.....	19,847,000.00
	$42,800,719.14

The Class 4 banks have agreed to take this amount in compromise of disputes respecting the validity of their security interest in the stock of Bankers and Northern. As noted above, under the Revolving Credit Agreement, EFCA pledged 100% of the stock of Northern to the Class 4 banks. Through a bizarre series of events occurring in March of 1973, the Class 4 banks released their security interest in all but 20% of the Northern stock. The release was obtained by fraud on the part of officers of EFCA. Upon discovery of the fraud, and before April 5, 1973, the Class 4 banks took steps to rescind the release and to reinstate their security interest in full. In short, the issue is whether these efforts were successful, and, if so, whether the reinstatement of the security in these circumstances was a preference. The facts surrounding these events have been thoroughly investigated by the Trustee and are not in serious dispute. But as to the legal consequences of these events, there is a bona fide dispute. Those disputed legal issues have been exhaustively

briefed by the interested parties whose briefs demonstrate that the authorities do not supply clear answers to the questions involved.

Under the Revolving Credit Agreement EFCA also pledged 100% of the stock of Bankers to the Class 4 banks. But that pledge is clouded because former shareholders of Bankers claim a right to rescind the transaction by which EFCA initially acquired the Bankers stock, and they further claim that this right to rescission is superior to the lien of the Class 4 banks. As noted below, whether the right of rescission survives Chapter X proceedings is disputed. Further, whether that right would be superior to the lien of the Class 4 banks turns on disputed questions of fact and law which have been thoroughly briefed by counsel.

In summary, the contentions are as follows: As part of the acquisition of Bankers, EFCA agreed in writing with the New York Insurance Department[15] that it would not pledge the Bankers stock without approval of the Department. That approval was not obtained when EFCA pledged the Bankers stock to the Class 4 banks. The question is whether the Class 4 banks are charged with knowledge of this agreement, and, if so, whether that knowledge subordinates their lien to the rescission claim of the former Bankers stockholders. The evidence on the factual issues is subject to conflicting inferences, and the questions of law are complex and open to bona fide dispute. If the claims of the former Bankers stockholders were

---

[15]EFCA needed the approval of the New York Department because Bankers owned EFNY, a New York based insurance company.

BLEED THROUGH

upheld, the Class 4 banks would hold a security interest in but 30%[16] of the Bankers stock.[17]

Furthermore, the value of the Class 4 banks' security interest in Bankers stock is questionable. As noted below, Class 8 creditors assert a claim for fraud or Securities Acts violations against Bankers, which, if successful, would render Bankers stock valueless.

The validity of the Class 4 banks' security interest in 60% of the stock of EFLIC is undisputed. But that stock probably has no value.

As noted above, two days before the filing of the reorganization petition herein, the banks in Class 4 holding $7,953,719.14 in demand deposits of EFCA offset their claims under the Revolving Credit Agreement against those deposits. Although Section 68 of the Bankruptcy Act (11 US.C. § 108) expressly permits the set-off of mutual debts or credits, there remains the issue whether an offset may be effected within four months prior to a Chapter X proceeding.

---

[16]As noted below, the Trustee estimates that approximately 30% of the former Bankers shareholders may have sold the EFCA stock they received in the Bankers acquisition. Since those persons no longer have a rescission claim to assert, the lien of the Class 4 banks, absent other factors discussed herein, would be valid as to approximately 30% of the value of Bankers.

[17]The Advisory Report at page 49 notes that if the failure to secure the approval of the New York Department defeats the pledge, the Trustee, as a perfected lien creditor under Section 70(c) of the Bankruptcy Act [11 U.S.C. § 110(c)], could defeat the security interest of the banks as to 100% of the stock and not just 70%. As the report also notes, the premise that the failure to secure approval defeats the pledge is tenuous.

To recapitulate, the claims of and provisions for the Class 4 banks are as follows:

Amount offset on April 3, 1975	$ 7,953,719.14
Balance of principal	42,581,969.05
Total claim prior to offset	50,535,688.19
Post-petition interest and fees (approx.)	15,600,000.00
Total claim if fully secured	$66,135,688.19
Value of recovery under the Plan	$42,800,000.00

If the Class 4 banks have a security interest in 100% of Northern and in 30% of Bankers, or in 100% of Bankers and 20% of Northern, then based on the reorganization value of those companies the banks would collect their full claim of $66.1 million, regardless of their offsets. Under these circumstances the value of the assets available for distribution to other creditors would be $23.3 million less than the recovery available under the Plan. Further, if the offsets are upheld, and if the banks' security interest in either Bankers or Northern is upheld, they will recover a total of either $59 million or $62.3 million.

The Class 4 banks would receive less than the Plan provides for them only if they should lose on all issues. This would occur if their offsets were held invalid, their security interest in Northern were held to be but 20%, and their security interest in Bankers were held to be 30% or valueless. Under these conditions, the banks would have a claim in Class 6 for $50,535,688.19 and, if they were to recover the same percentage as Class 6 recovers in the Plan, the banks would then get between $38.4 million and $40.4 million.

Since the issues affecting the Class 4 banks' security interest are open to debate and since the banks' recovery

BLEED THROUGH

under the Plan is near the lower range of recovery from litigation, the settlement with the Class 4 banks is fair and equitable.

B. *Creditors Class 4.1—Secured Creditors—Bankers Trust Company and Israel Discount Bank*

Creditors in Class 4.1 hold notes of EFCA totaling $5,105,000, secured by a pledge of 40% of the stock of EFLIC. The validity of their security interest in the stock is undisputed. Thus, if the stock had sufficient value, the Class 4.1 creditors would be entitled to full recovery of principal, together with post-petition interest. Although EFLIC has been declared insolvent, the EFLIC Plan of Liquidation provides for certain distributions to the Trustee. The Trustee contends that these distributions are made to him as a creditor of EFLIC. The Class 4.1 creditors contend that these distributions are made to the Trustee as the stockholder of EFLIC, and that their security interest attaches to those distributions.

To settle these disputed issues, the Plan proposes to recognize the Class 4.1 creditors as secured to the extent of $350,000 out of their total claims of $5,105,000. The balance of their claims will be dealt with as unsecured claims in Class 6. The chances of Class 4.1 creditors boosting their claims to secured status are relatively small. Thus, the relatively small provision for them as secured creditors is in keeping with the litigation possibilities, and so the Plan in this respect is fair and equitable.

C. *Creditors Class 5—Bankers Rescission Claimants*

Creditors in Class 5 consist of persons who received EFCA stock in exchange for stock of Bankers upon its acquisition by EFCA and who continue to hold such stock. The Class 5 creditors claim the right to rescind EFCA's acquisition of Bankers stock and to reclaim their Bankers stock. This claim raises fundamental legal and policy considerations. The general rule is that a person defrauded of property is entitled to reclaim it, if he can trace it. If this rescission claim were upheld here, the former Bankers stockholders would regain possession of their Bankers stock or its equivalent value.

About 70% of the former Bankers stockholders still hold the EFCA stock which they received in exchange for their Bankers stock. Based on a reorganization value of Bankers of $51,121,000 as of March 31, 1976, the potential claims in this class would total $35,784,700.

Several arguments can be advanced against the Class 5 claimants. Specifically, those arguments are that the right of reclamation does not survive Chapter X proceedings, that the security interest of the Class 4 banks as bona fide pledgees cuts off the right of reclamation, that the extension of credit by bona fide creditors in reliance on EFCA's ownership of Bankers cuts off the right of reclamation, and finally, that, in any event, the stock of Bankers is valueless because of fraud claims asserted against Bankers. If the rescission claims are defeated, creditors in Class 5 would rank with those in Class 8 and as such would, at best,

BLEED THROUGH

recover a fraction of their claims, and, at worst, recover nothing at all.

Given the seriousness of the claim asserted by creditors in Class 5, it is appropriate that the Plan make substantial provision for them. On the other hand, because of the arguments against the reclamation claim, it is appropriate that this claim not be recognized in full. The Plan allots to Class 5 a pool of 1,120,000 shares of stock of New Company, having a reorganization value of $12.3 million, or 34.4% of the maximum aggregate claim. Such distribution, in the light of the issues in controversy, is fair and equitable.

D. *Creditors Class 8—Fraud Claimants*

Class 8 is comprised of persons or entities who were damaged as a result of their acquisition of securities issued or guaranteed by EFCA, whose claims do not fall within Classes 5, 6, or 7. Accordingly, Class 8 includes all present EFCA stockholders and those persons or entities who lost money from trading in EFCA stock or debt instruments. The amount of damages suffered by Class 8 creditors can only be estimated, but a reasonable figure is approximately $170 million.

Creditors in Class 8 raise a serious issue of law. They contend that they have claims against EFCA for common-law fraud and Securities Acts violations which should rank on a parity with the claims of general unsecured creditors. The Trustee has acknowledged that persons (other than those who had knowledge of the machinations within EFCA) who acquired EFCA securities over the years were the victims of fraud and Securities Acts violations. There is authority for

the proposition that a fraud claim, even if based upon stock acquisition, is on a parity with general unsecured claims in a reorganization proceeding. Acceptance of this proposition would probably violate the expectations of all parties, because stockholders ordinarily are entitled to no recovery from an insolvent company. This bona fide issue has not been authoritatively resolved. If the claims of Class 8 creditors were ranked on a parity with the claims of general unsecured creditors, then Classes 5, 6, 7, and 8 would share equally in the assets available, resulting in a distribution of approximately 28 cents per dollar of claim for creditors in these classes.

Another factor affecting the position of Class 8 creditors is the existence of claims asserted by these creditors against EFCA's subsidiaries. These claims were first asserted in the Multi-District Actions. These subsidiaries were sued as aiders, abettors, or co-conspirators in the EFCA fraud. Under this theory, those who have claims against EFCA arising under common-law fraud or Securities Acts violations also have claims against these subsidiaries. On March 5, 1975, this Court enjoined prosecution of those claims in the Multi-District Actions, pending these Chapter X proceedings, and required all those asserting such claims to do so in these Chapter X proceedings. *In re Equity Funding Corp. of America, supra* at 1276-77.[18] Following issuance of that preliminary injunction, claims were filed herein on behalf of defrauded EFCA securityhold-

[18]The injunction did not apply to claims of this nature which had been asserted against EFLIC, since these claims were compromised in the EFLIC liquidation proceedings in Illinois. *In re Equity Funding Corp. of America, supra* at 1277.

BLEED THROUGH

ers, seeking recovery on the theory that Bankers, Northern, and other subsidiaries had participated in the EFCA fraud. Discovery was taken on the question of the implication of Bankers in the fraud, and memoranda on this issue were filed with the Court. While similar claims have been asserted with regard to other subsidiaries of EFCA, none of these other claims appears to have significant factual support.

If Bankers' implication in the fraud were successfully established, the value attributable to Bankers, *i.e.*, $51,121,000 as of March 31, 1976, would be proportionately distributed to all creditors who acquired securities of EFCA or extended credit to EFCA in reliance upon its fraudulent statements. Arguably, this group could include substantially all claimants in Classes 4, 4.1, 5, 6, 7, and 8, resulting in a distribution of 13.5 cents per dollar of claim. Furthermore, if Bankers were implicated in the EFCA fraud, the stock of Bankers would be rendered valueless. In that case, the rescission claims by the former Bankers stockholders and the security interest in the Bankers stock held by the Class 4 banks would likewise be rendered valueless.

If Class 8 creditors lose on the two disputed matters discussed above, they would receive nothing.

The Court therefore concludes that it is proper for the Plan to provide for a distribution to Class 8 creditors. The Plan creates a pool of 1,900,000 New Company shares, having a reorganization value of $20,938,000, to be distributed among Class 8 claimants. While the amount of those claims cannot now be determined, a reasonable approximation is $170 million. Accordingly, based on New Company's reorganization value, Class 8 claimants would receive one share of

stock for each $89.48 of adjusted loss, or 12.3 cents per dollar of claim. Since the amount of claims cannot be precisely predicated, each claimant may receive a greater recovery per dollar of claim if less than $170 million of Class 8 claims are allowed. Accordingly, the Plan puts a ceiling of 22 cents per dollar of claim on their recovery. The Court finds this compromise to be fair and equitable.

The Plan contains provisions for measuring the damages suffered by Class 8 claimants. The evidence shows that EFCA's fraudulent financial statements inflated the value of its stock for many years, but the existence of the EFCA fraud was unknown to the investing public and had no downward effect on market prices prior to the close of business on March 16, 1973. Accordingly, it is probable that losses experienced by investors in EFCA securities from fluctuations in its market price prior to that date were proximately caused by market conditions rather than the EFCA fraud. As a result, there is a substantial issue whether damages suffered before the close of business on March 16, 1973 would be recoverable in this Chapter X proceedings. In compromising that issue, the Plan recognizes such losses only to the extent of 20% thereof. The evidence shows that, following the close of business on March 16, 1973, rumors of the fraud caused a depressing effect upon the market and that the decline in market price after that time was proximately caused by the EFCA fraud. Therefore, the decline after that date is recognized in full in the Plan.

BLEED THROUGH

E. *Creditors Classes 6 and 7—General Unsecured Unsubordinated Creditors and Holders of Subordinated Debt Instruments*

Class 6 creditors are the general unsecured, unsubordinated creditors of EFCA. Most claims in this class involve holders of notes and debentures issued or guaranteed by EFCA. Total allowed claims in this class approximate $44.4 million, including pre-petition interest.

Class 7 creditors are the holders of notes or debentures issued or guaranteed by EFCA which are, by their terms, subordinated to senior debt. The total amount of allowed claims in this class is approximately $64.2 million, including pre-petition interest.

The Plan provides for distribution of New Company stock to Class 6 creditors at the rate of one share of stock for every $14.50 of claims. In the aggregate, this amounts to approximately $33.8 million of stock. In addition, a cash distribution of up to $1.4 million may be made to Class 6.[19] Thus, the value of the distribution to Class 6 will vary from 76.1% to 80% of the total claims. Certain creditors in Class 6 are entitled to include pre-petition interest within their claims. The total recovery of such creditors, when measured against only the principal of their claims, will constitute a higher percentage. In the case of the 9½% Debentures, due 1990, the percentage ranges from 79.24% up to 83%.

Creditors in Class 7 will receive one share of New Company stock for each $35 of claims. This will

[19]This cash is to come from any settlement with or judgment against the defendants in the Trustee's action against the persons who audited EFCA and its subsidiaries. *See* Part VI B, *infra*.

total approximately $24.2 million of stock for a recovery of 31.5% of total claims allowed, including pre-petition interest.

Settlement of the claims of Classes 5 and 8 has a direct impact on the distributions that otherwise would be made to creditors in Classes 6 and 7. Each indenture under which the Class 7 debentures were issued provides: (1) for their subordination in reorganization and (2) for payment to "senior" debt, as defined in said indentures, of anything of value that may be received by the holders of Class 7 debentures through reorganization, until senior debt has been paid in full. The portion of the indenture governing the 5½% EFCA Convertible Subordinated Debentures, due 1991 is set out in Appendix IV. This subordination provision is typical of those contained in the indentures that govern the other debt instruments in Class 7. Most of the debt in Class 6 is senior indebtedness, as that term is defined in these indentures. This Court in these proceedings is required to enforce the subordination provisions. *In re Credit Industrial Corp.*, 366 F.2d 402, 409 (2d Cir. 1966); *In re Associated Gas & Electric Co.*, 53 F.Supp. 107, 111 (S.D.N.Y. 1943), *aff'd sub nom. Elias v. Clarke*, 143 F.2d 640 (2d Cir.), *cert. denied*, 323 U.S. 778 (1944); 6A W. Collier, *supra*, ¶9.10, at 219; 3A W. Collier, *supra* ¶65.06[2], at 2299; Calligar, *Subordination Agreements*, 70 Yale L.J. 376, 383-92 (1961).

If no provision for settlements with Classes 5 and 8 were made, the assets available for distribution to Classes 6 and 7 would total about $87.2 million, even after providing for Classes 1, 2, 3, 4, and 4.1.

BLEED THROUGH

Under these circumstances, Class 6 creditors would receive a distribution equal in reorganization value to the full amount of their claims—a total of $44.4 million. And creditors in Class 7 would receive the balance—a total of $42.8 million. Since claims in Class 7 total about $64.2 million, Class 7 would then receive a reorganization value distribution of 66.7 cents on the dollar.

However, if the claims in Classes 5 and 8 were successfully litigated, the impact on Classes 6 and 7 would be catastrophic. Of the $87.2 million otherwise available for Classes 6 and 7, $35.8 million would go to Class 5. The balance of $51.4 million would then be divided *pari passu* among the claims in Classes 6, 7, and 8. Under this *pari passu* division, Class 6 would receive $8.19 million and Class 7 would receive $11.84 million,[20] or 18.4% of their claims.

The Plan protects Classes 6 and 7 from such a division by providing for a settlement with Classes 5 and 8. To provide for this settlement, after giving a full effect to the subordination provisions as between Classes 6 and 7, the reorganization value of the respective distributions to Classes 6 and 7 must then be reduced.

---

[20]If fraud claims were entitled to share *pari passu* with general creditor claims, as is assumed in this discussion, creditors in Class 7 might avoid the effect of the subordination provisions mentioned earlier by asserting tort claims for fraud or Securities Acts violations rather than contract claims based upon the terms of their debentures. Since such claims would not be based upon the applicable contractual terms, the recovery might not be subject to the restrictions contained in those contracts. Even if the subordination provisions were held applicable to a tort recovery by creditors in Class 7, so that such recovery was diverted to Class 6, Class 6's total recovery would still be less than the Plan provides.

The reduction of the recovery by Classes 6 and 7 in the Plan is fair and reasonable. The amount diverted from Class 7 is larger, both proportionately and absolutely. This reduction is justified because if the claims in Class 5 succeed while claims in Class 8 fail, Class 6 would still be paid in full while Class 7 would receive little. On the other hand, the recovery by creditors in Class 6 should be reduced below 100 cents on the dollar for two reasons. First, as previously noted, successful litigation of the claims of Classes 5 and 8 would result in a drastic reduction in the recovery by Class 6. Second, as discussed above, Class 7 would probably receive some distribution, even if the claims of Classes 5 and 8 were successfully litigated. This factor distinguishes the present case from one where subordinated creditors would not be entitled to participate in the reorganization of the debtor under any possible result of litigation. *See Case v. Los Angeles Lumber Products Co., supra; In re Associated Gas & Electric Co., supra.*

Thus, the Plan makes provision for the settlements mentioned above and ensures that the distribution to Class 7 is free and clear of any further claims based upon the subordination agreements, since the agreements are fully recognized by the Plan.

F. Recapitulation

To recapitulate, the following table shows the claims of creditors in each of the classes discussed above, the reasonable value of cash and notes that will be retained by or distributed to Class 4, the reorganization value of the stock that will be distributed to Classes 5, 6, 7, and 8 under the Plan, Class 6's additional

BLEED THROUGH

potential cash recovery, the percentage of New Company that each of Classes 5, 6, 7, and 8 will own as a result of these distributions, and the percentage recovery of each class.

Distribution Under the Plan.[21]

	No. of Shares	% of New Company	Value of Recovery in Millions	Amount of Claims in Millions	Percent Recovery
Class 4	—	—	$ 42.8	$ 66.1	64.8
Class 5	1,120,000	14.1	12.3	35.8	34.4
Class 6	3,062,448	38.7	33.8 to 35.2	44.4	76.1 to 80
Class 7	1,834,812	23.2	20.2	64.2	31.5
Class 8	1,900,000	24.0	20.9	170.0	12.3
	7,917,260	100.0	$130.0	$380.5	

Reorganization value per share: $11.02

VI. MISCELLANEOUS PROVISIONS OF THE PLAN

A. *Injunction Against Further Prosecution of Certain Claims and Payment of $250,000 Into Multi-District Action Court*

The Plan contemplates dismissal of the Multi-District Actions against EFCA's subsidiaries (other than EFLIC) upon the entry of this Court's order making permanent its preliminary injunction dated April 11, 1975. *In re Equity Funding Corp. of America, supra* at 1276-77. Entry of such an order will expeditiously dispose of the Multi-District Actions against EFCA's subsidiaries. Accordingly, the order confirming the Plan will make the preliminary injunction permanent.

---

[21]Class 4.1 is omitted from this table, because the impact of the compromise with this class upon the recovery of other classes is de minimus.

The injunction will prohibit EFCA securityholders and creditors from prosecuting EFCA's wholly-owned subsidiaries (other than EFLIC) in the Multi-District Actions or in any other proceedings, except these Chapter X proceedings for claims based upon the alleged participation by any such subsidiary as an aider, abettor, or co-conspirator in the EFCA fraud, if the subsidiary's participation was directed by an officer or employee of EFCA. This Court's Memorandum and Order dated April 11, 1975 sets forth the jurisdictional basis and the reasons for the issuance of the preliminary injunction. *See In re Equity Funding Corp. of America, supra.* A permanent injunction is justified by the factors and reasons set forth in that Memorandum and by provisions in the Plan made in compromise of claims based on alleged fraud and Securities Acts violations by EFCA and by EFCA's subsidiaries as well. These provisions consist of a pool of 1,900,000 shares for Class 8, a pool of 1,120,000 shares for Class 5, and paragraph 9.1 of the Plan, which provides for the payment of $250,000 by the Trustee into the registry of the Multi-District Action Court. This sum is to be used for the benefit of the plaintiff classes as may be defined by the Multi-District Action Court, in such manner as said Court may order.

B. *Provisions Respecting Actions Against Accountants*

Paragraph 9.3 of the Plan deals with the Trustee's pending litigation against accounting firms that audited the books of EFCA and EFLIC. The Trustee's complaint alleges that these accountants failed to follow generally accepted auditing standards and were therefore negligent. The Trustee not only seeks to recover the

BLEED THROUGH

fees paid to these accountants but also to recover from them the damages suffered by EFCA because of their failure to detect through audit the fraud perpetrated within EFCA and EFLIC. This litigation against the accountants has been consolidated in the Multi-District Actions.

Complaints filed by or on behalf of essentially all holders of EFCA securities are also pending in the Multi-District Actions against these same auditors. These complaints, which seek recovery of investment losses in EFCA securities, allege identical dereliction of duty by the auditors. The recovery sought in the Trustee's action and in the securityholders' actions is enormous, and could exceed the ability of the auditors to respond through insurance coverage or otherwise. Thus, the Trustee and EFCA securityholders are competing for the same recovery dollars in the Multi-District Actions against the accountants.

Paragraph 9.3 of the Plan eliminates that competition. It sets up a mechanism whereby any recovery in the Multi-District Actions from the accountant-defendants will be divided equally between the Trustee and a class or classes of plaintiffs who held EFCA stock and debentures on March 27, 1973, until the Trustee has recovered the sum of $2.4 million plus certain fees, advances and costs. Thereafter any recovery will be allocated entirely to the other plaintiffs.

This compromise is justified by two factors. First, there is a legal question whether the Trustee can recover from the accountant-defendants beyond the fees paid to them. Second, the Multi-District Action class plaintiffs who will benefit from the recovery are all creditors of EFCA in these proceedings; therefore, substantially

the same group of plaintiffs will benefit (although in different proportions *inter se*) whether recovery from the accountants flows to the Trustee or to the class plaintiffs.

Paragraph 9.3 further provides that 7/12ths of all proceeds received by the Trustee pursuant to the compromise, other than reimbursement of fees, advances and costs, will be distributed to creditors in Class 6 in proportion to their claims. This is a portion of the total distribution to Class 6 creditors heretofore discussed and is justified for the reasons stated in part V.

C. *Provision for Claims for Indemnity and Contribution*

The Plan provides for indemnity claims based upon charter or bylaw provision of EFCA or upon state statutes. Under paragraph 2.7(vi) of the Plan, a claim for indemnity will be allowed in Class 6 only for legal and other expenses incurred in defending actions asserting fraud claims, and only if those actions terminate other than by settlement without a determination of liability for fraud on the part of the indemnity claimant. If a fraud claim is terminated by settlement, indemnity will be allowed only if approved by the Trustee with the consent of this Court. Fraud claims are defined as claims for damages or rescission based on violations of any federal or state securities laws, or on fraud, deceit, conspiracy, breach of warranty, or on any other breach of duty in connection with the acquisition of any EFCA security.

A pool of 50,000 shares is set aside for claims in this category, which will be paid at the rate of

BLEED THROUGH

one share per $14.50 of allowed claim. No provision is made for claims based upon contribution. Two individuals who acted as accountants for EFCA and who are now defendants in the Multi-District Actions have objected to paragraph 2.7(vi) because it fails to provide indemnity or contribution in the event of an adverse judgment.

The Court overrules those objections and finds that the provision respecting indemnity claims and the lack of provision for contribution claims are fair and equitable, for three reasons.

First, the plaintiffs in the Multi-District Actions are also EFCA's creditors who will receive the benefit of all EFCA's assets under the Plan. Thus, if EFCA is required to deliver assets by way of indemnity or contribution to unsuccessful fraud claimants in the Multi-District Actions, those assets must perforce be taken from the successful defrauded plaintiffs who are EFCA's creditors. Such a result would, in the final analysis, permit the indemnity or contribution claimants to benefit from their wrongful conduct—an unconscionable result. Looking at the other side of the coin, the use of EFCA's assets to reduce losses sustained by EFCA's defrauded investors, of necessity, reduces the amount of their fraud claims against the Multi-District Action defendants, which include the two objecting accountants. Thus, those accountants, who are indemnity and contribution claimants, benefit as much from the Plan as they would if indemnity and contribution were allowed.

Second, the policy of the securities laws precludes indemnification of an unsuccessful defendant in all except extraordinary circumstances such as the indem-

nification of a corporation by its officers or directors who caused it to engage in the conduct giving rise to the liability. *Globus v. Law Research Service, Inc.*, 418 F.2d 1276, 1288 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970); *Thomas v. Duralite Co.*, 386 F. Supp. 698 (D. N.J. 1974). And this policy has been applied even where the liability of the party claiming indemnity is based upon negligence. *Gould v. American-Hawaiian Steamship Co.*, 387 F. Supp. 163 (D. Del. 1974); *Odette v. Shearson, Hammill & Co.*; CCH Fed. Sec. L. Rep. ¶ 95,038 (S.D.N.Y. 1975).

Third, Section 57 (i) of the Bankruptcy Act [11 U.S.C. 93 (i)] and Rule 304 of the Federal Rules of Bankruptcy Procedure, which are applicable in Chapter X proceedings, preclude contribution claims. *See* 3 W. Collier, *supra* ¶ 57.21. *See also Newport Air Park, Inc. v. United States*, 419 F.2d 342 (1st Cir. 1969); *Fidelity & Deposit Co. of Maryland v. Fitzgerald*, 272 F.2d 121, 128 (10th Cir. 1959); *Rowe v. John C. Motter Printing Press Co.*, 273 F. Supp. 363, 365 (D. R.I. 1967).

VII. CONCLUSION

Section 174 of the Bankruptcy Act (11 U.S.C. § 574) provides that an order shall be entered approving a Plan if, in the opinion of the Court, the Plan complies with the provisions of Section 216 of the Bankruptcy Act (11 U.S.C. § 616), and is fair and equitable, and feasible. For all of the reasons set forth in this Memorandum, the Court is of the opinion that the Trustee's Plan meets these criteria. Accordingly, the Court approves the Plan and orders it transmitted

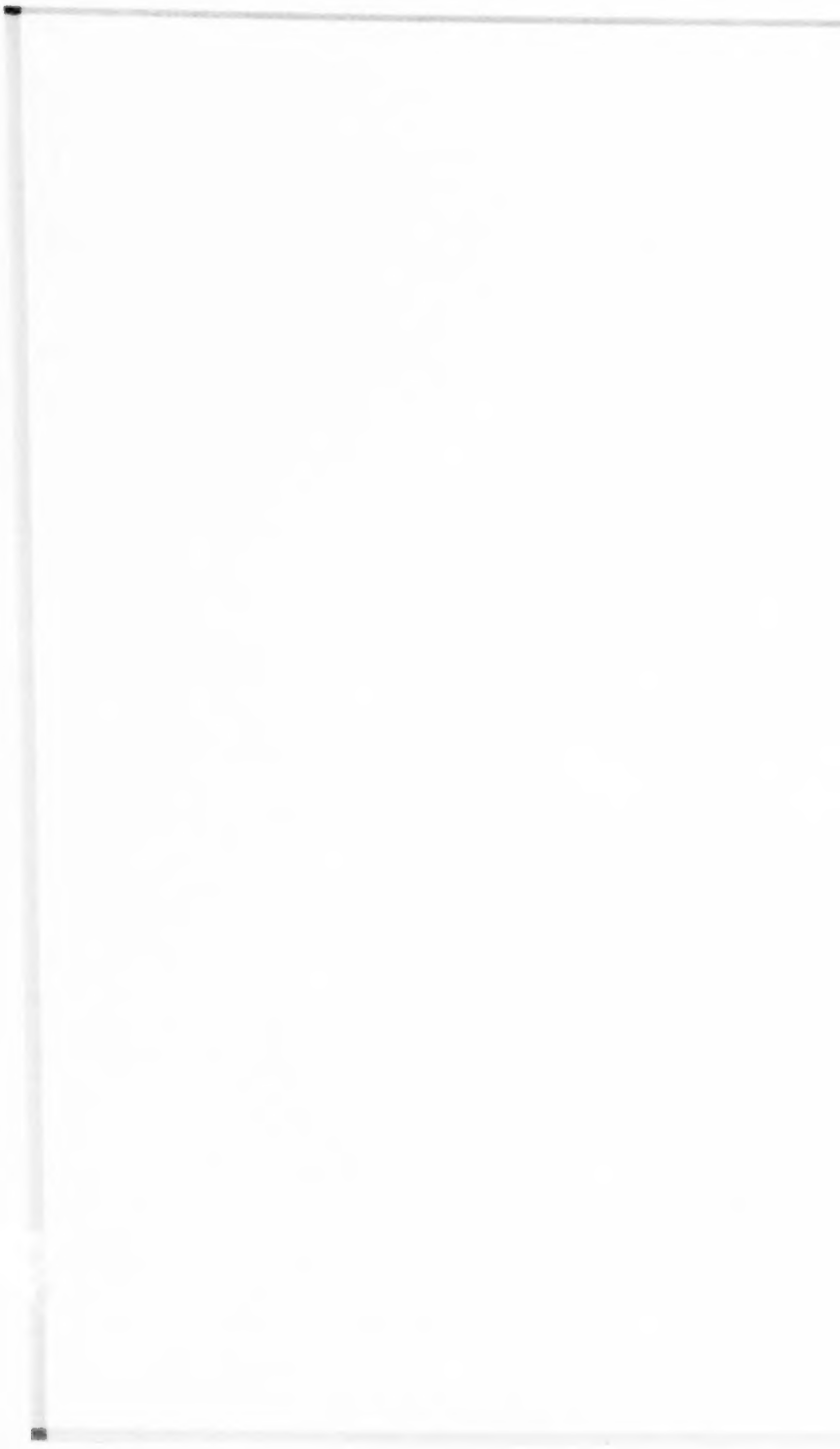
BLEED THROUGH

to the creditors of the estate for their acceptance or rejection, in accordance with the orders herein dated December 8, 1975.

This Memorandum shall constitute the Court's findings of fact and conclusions of law under Rule 52(a) of the Federal Rules of Civil Procedure and Rules 752, 914 and 10-901 of the Federal Rules of Bankruptcy Procedure.

Dated: December 8, 1975.

HARRY PREGERSON
Harry Pregerson
United States District Judge



BLEED THROUGH

COPY BOUND VERTICALLY

NEW COMPANY

PROJECTED CASH FLOW

(000's Omitted)

CASH FLOW BY YEAR

	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
CASH SOURCES:													
Dividends* from Insurance Subsidiaries	$2,512	$2,413	$2,980	$3,494	$3,955	$4,422	$4,852	$5,566	$6,118	$6,530	$ 6,530	$ 6,530	$ 6,530
Start-up Loan	2,000	—	—	—	—	—	—	—	—	—	—	—	—
Proceeds from Sale of Cattle Group	—	—	5,500	—	—	—	—	—	—	—	—	—	—
Re-investment Income @ 7%	227	381	505	436	349	337	342	374	406	498	712	953	1,222
Cash from Non-Cash Assets	—	—	—	—	—	671	—	—	—	—	—	—	—
Total Sources	$4,739	$2,794	$8,985	$3,930	$4,304	$5,430	$5,194	$5,940	$6,524	$7,028	$ 7,242	$ 7,483	$ 7,752
CASH USES:													
Senior Notes ($8,060 Issued):													
Principal	$ —	$ —	$5,500	$ —	$ —	$ —	$ —	$ —	$2,560	$ —	$ —	$ —	$ —
Interest	666	887	394	230	230	230	230	230	115	—	—	—	—
Income Notes ($27,582 Issued):													
Principal	—	—	—	2,450	2,450	2,450	2,450	2,964	2,964	2,964	2,964	2,964	2,964
Cash Interest	—	—	1,449	1,803	1,631	1,459	1,287	1,088	880	675	468	260	52
Interest Notes Paid	—	—	579	772	772	772	772	193	—	—	—	—	—
Total Debt Service	$ 666	$ 887	$7,922	$5,255	$5,083	$4,911	$4,739	$4,475	$6,519	$3,639	$ 3,432	$ 3,224	$ 3,016
Administrative Expenses	150	220	242	266	293	322	354	389	429	472	519	571	628
Total Uses	$ 816	$1,107	$8,164	$5,521	$5,376	$5,233	$5,093	$4,864	$6,948	$4,111	$ 3,951	$ 3,795	$ 3,644
Excess (Deficit) Cash	$3,923	$1,687	$ 821	($1,591)	($1,072)	$ 197	$ 101	$1,076	$ (424)	$2,917	$ 3,291	$ 3,688	$ 4,108
Beginning Cash	$ -0-	$3,923	$5,610	$6,431	$4,840	$3,768	$3,965	$4,066	$5,142	$4,718	$ 7,635	$10,926	$14,614
Add: Excess (Deficit) Cash	3,923	1,687	821	(1,591)	(1,072)	197	101	1,076	(424)	2,917	3,291	3,688	4,108
ENDING CASH	$3,923	$5,610	$6,431	$4,840	$3,768	$3,965	$4,066	$5,142	$4,718	$7,635	$10,926	$14,614	$18,722

* Based on 50% of the statutory earnings of Bankers and 50% of the statutory earnings of Northern.

BLEED THROUGH

COPY BOUND VERTICALLY

NEW COMPANY

PROJECTED CONSOLIDATED EARNINGS (GAAP)

(000's Omitted)

	1976	1977	1978	1979	1980	1981	1982	1983
TOTAL LIFE INSURANCE SUBSIDIARIES								
Premium and Other Income	$ 52,831	$ 58,783	$ 66,448	$ 74,169	$ 82,101	$ 90,043	$ 97,956	$106,650
Investment Income	20,524	23,077	25,949	28,975	32,154	35,489	38,964	42,618
Total Income	$ 73,355	$ 81,860	$ 92,397	$103,144	$114,255	$125,532	$136,920	$149,268
Provision for Benefit of Policyholders	$ 45,625	$ 51,042	$ 57,685	$ 64,546	$ 72,008	$ 79,568	$ 86,727	$ 95,094
Expenses	12,798	12,952	14,585	16,491	18,266	20,003	22,094	24,069
Total Deductions	$ 58,423	$ 63,994	$ 72,270	$ 81,037	$ 90,274	$ 99,571	$108,821	$119,163
Federal Income Tax	$ 2,697	$ 3,896	$ 4,798	$ 5,662	$ 6,142	$ 6,824	$ 7,382	$ 8,063
Net Income Before Allocation To Policyholders Surplus	$ 12,235	$ 13,970	$ 15,329	$ 16,445	$ 17,839	$ 19,137	$ 20,717	$ 22,042
Provision for Policyholders Share of Participating Earnings	$ 2,359	$ 2,570	$ 2,687	$ 2,765	$ 2,840	$ 2,921	$ 2,941	$ 2,977
Net Income of Life Insurance Subsidiaries	$ 9,876	$ 11,400	$ 12,642	$ 13,680	$ 14,999	$ 16,216	$ 17,776	$ 19,065
PARENT COMPANY								
Investment Income	$ 227	$ 381	$ 505	$ 436	$ 349	$ 337	$ 342	$ 374
Interest Expense-Income Notes	1,448	1,931	1,931	1,802	1,631	1,459	1,287	1,089
Amortization of Discount-Income Notes	393	791	1,072	1,037	941	835	714	577
Interest Expense-Senior Notes	666	887	394	230	230	230	230	230
Administration Expense	150	220	242	266	293	322	354	389
CONSOLIDATED EARNINGS	$ 7,446	$ 7,952	$ 9,508	$ 10,781	$ 12,253	$ 13,707	$ 15,533	$ 17,154

BLEED THROUGH

NEW COMPANY
Reorganization Value at March 31, 1976
(000's Omitted)

ASSETS

Cash	$ 2,000
Bankers	51,121
Northern	54,315
Securities Group	1,575
Cattle Group	5,500
Non Cash Assets	671
Contingent Assets	—0—
Total Assets	$115,182

LIABILITIES AND STOCKHOLDERS' EQUITY

Debt		
Senior Notes		$ 8,060
Income Notes		
Face Amount	$ 27,582	
Less Unamortized Debt Discount	7,735	19,847
Total Debt		$ 27,907
Equity		
Common Stock		
Authorized 9,000,000		
Estimated to be Issued and Outstanding	7,917,260	87,275
		$115,182

BLEED THROUGH

APPENDIX IV TO MEMORANDUM AND ORDER.

The Indenture governing the 5½% Convertible Subordinated Debentures due 1991, provides in pertinent part:

"ARTICLE THIRTEEN
"SUBORDINATION OF DEBENTURES

"Section 1301. *Agreement of Subordination.*

"The Company covenants and agrees, and each Holder of Debentures issued hereunder by his acceptance thereof likewise covenants and agrees, that all Debentures shall be issued subject to the provisions of this Article Thirteen; and each Person holding any Debenture, whether upon original issue or upon transfer or assignment thereof, accepts and agrees to be bound by such provisions.

"All Debentures issued hereunder shall, to the extent and in the manner hereinafter set forth, be subordinated and subject in right of payment to the prior payment in full of all Superior Indebtedness.

"Section 1302. *Payments to Debentureholders.*

"Upon any acceleration of the principal of the Debentures or any payment by the Company, or distribution of assets of the Company of any kind or character, whether in cash, property or securities, to creditors upon any dissolution or winding-up or total or partial liquidation or reorganization of the Company, whether voluntary or involuntary or in bankruptcy, insolvency, receivership or other proceeding, all amounts due or to become due upon all Superior Indebtedness shall first be paid in full, or payment thereof provided for in money or money's worth in accord-

ance with its terms, before any payment is made on account of the principal (and premium, if any) or interest of the Debentures . . . ; and upon any such dissolution or winding-up or liquidation or reorganization any payment by the Company, or distribution of assets of the Company of any kind or character, whether in cash, property or securities, to which the Holders of the Debentures or the Trustee would be entitled, except for the provisions of this Article Thirteen, shall be paid by the Company or by any receiver, trustee in bankruptcy, liquidating trustee, agent or other Person making such payment or distribution directly to the holders of Superior Indebtedness (pro rata to such holders on the basis of the respective amounts of Superior Indebtedness held by such holders) or their representative or representatives, or to the trustee or trustees under any indenture pursuant to which any instruments evidencing any Superior Indebtedness may have been issued, as their respective interests may appear, to the extent necessary to pay all Superior Indebtedness in full, in money or money's worth in accordance with its terms, after giving effect to any concurrent payment or distribution to or for the holders of Superior Indebtedness, before any payment or distribution is made in respect to the Debentures to the Holders of the Debentures or to the Trustee.

"In the event that, notwithstanding the foregoing, any payment by or distribution of assets of the Company of any kind or character, whether in cash, property or securities, prohibited by the foregoing, shall be received by the Trustee or the Holders of the Debentures before all Superior

BLEED THROUGH

Indebtedness is paid in full, or provision is made for such payment in money or money's worth in accordance with its terms, such payment or distribution shall be paid over or delivered to the holders of Superior Indebtedness or their representative or representatives, or to the trustee or trustees under any indenture pursuant to which any instruments evidencing any Superior Indebtedness may have been issued, as their respective interests may appear, for application to the payment of all Superior Indebtedness remaining unpaid to the extent necessary to pay all Superior Indebtedness in full in money or money's worth in accordance with its terms, after giving effect to any concurrent payment or distribution to or for the holders of such Superior Indebtedness."

APPENDIX B.

Order.

United States Court of Appeals for the Ninth Circuit.

In the Matter of Equity Funding Corporation of America, a Delaware corporation, Debtor, Curtis B. Danning, Trustee in Bankruptcy of the Estate of Solomon Block, Marvin Al Lichtig, Appellants, vs. Robert M. Loeffler, Trustee in Reorganization of the Estate of Equity Funding Corporation of America, Appellee. No. 76-1052.

Before: DUNIWAY and WRIGHT, Circuit Judges.

Upon due consideration, the motion for stay pending appeal is denied.

Dated: February 18, 1976.

/s/ Ben C. Duniway
/s/ Eugene A. Wright
U.S. Circuit Judges

BLEED THROUGH

APPENDIX C.

Order (1) Confirming the Trustee's Plan; (2) Authorizing Substantial Consummation of the Trustee's Plan; (3) Appointing Directors and Officers; (4) Providing for Notice.

United States District Court, Central District of California.

In the Matter of Equity Funding Corporation of America, a Delaware Corporation, Debtor.

In Proceedings for the Reorganization of a Corporation. No. 73-03467.

Filed: Feb. 23, 1976.

On December 8, 1975, pursuant to Order No. B-0527, the Trustee's Amended Plan of Reorganization (dated December 5, 1975) (the "Trustee's Plan") was approved by this Court. Said Order directed that the Trustee transmit the Trustee's Plan to the creditors in Classes 4, 4.1, 5, 6, 7, and 8 for their acceptance or rejection. Said Order fixed February 10, 1976 as the date by which the creditors in said Classes must file written acceptances or rejections, and any objections to the Plan, and fixed February 23, 1976 as the date for the hearing on the confirmation of the Trustee's Plan. Notice of the date by which creditors must file written acceptances or rejections, and of the hearing on confirmation of the Trustee's Plan was given to the creditors in Classes 4, 4.1, 5, 6, 7 and 8.

On February 23, 1976, this Court held the hearing referred to above, at which hearing the Trustee filed his Certificate of Acceptances or Rejections of the Trustee's Plan, and proposed amendments to the Trustee's Plan in the form of a Plan "dated February

23, 1976" (all references hereinafter to the "Trustee's Plan" are to such Plan dated February 23, 1976), and the Court took evidence and heard argument of counsel on whether the Trustee's Plan should be confirmed.

Based upon the above, the Court makes the following findings of fact and conclusions of law:

(1) The proposed amendments to the Trustee's Plan do not materially or adversely affect the interests of creditors and stockholders.

(2) The Trustee's Plan has been accepted in writing by or on behalf of creditors holding two-thirds in amount of the claims filed and allowed in each class affected by the Trustee's Plan.

(3) The application of Rule 10-405 of the Federal Rules of Bankruptcy Procedure to this Proceeding would not be feasible and would work an injustice to the debtor estate and its creditors in that the Trustee and many interested parties participated in proceedings leading to the adoption of the Trustee's Plan prior to the effectiveness of the Federal Rules of Bankruptcy Procedure applicable to Chapter X proceedings and under the assumption that (a) the Trustee's Plan could be consummated following an entry of an order of confirmation even if an appeal therefrom, or from an order of approval, was then pending and (b) distribution of securities in accordance with the provision of Section 224 of the Bankruptcy Act would be governed by Section 204 of the Bankruptcy Act; and the Trustee and said interested parties changed their position in reliance on such assumptions.

(4) The provisions of Article VII, Section 199, and Article X of Chapter X of the Bankruptcy Act (11 U.S.C. § 501 *et seq.*) have been complied with.

BLEED THROUGH

(5) The Trustee's Plan is fair and equitable, and feasible.

(6) The proposal of the Trustee's Plan and its acceptances have been in good faith and not by means forbidden by law.

(7) All payments for services and for costs and expenses in, or in connection with, these proceedings or in connection with the Trustee's Plan and incident to the reorganization have been approved by prior order of the Court, or will be submitted after confirmation of the Trustee's Plan to this Court for approval prior to payment.

(8) The election and appointment as directors and officers of the New Company of the persons identified on Exhibit 1 hereto, is equitable and compatible with the interests of the creditors and stockholders and consistent with public policy.

WHEREFORE, it is hereby ORDERED, ADJUDGED and DECREED as follows:

1. The Trustee's Plan is confirmed.

2. The Trustee is authorized and directed to substantially consummate the Trustee's Plan on the 31st day of March, 1976 ("Transfer Date") in accordance with the terms and conditions of an Order in Aid of Substantial Consummation to be entered, unless

(a) This Court, by order, shall fix another date for said substantial consummation, or

(b) The Trustee in his discretion deems it in the best interests of the debtor estate to proceed with said substantial consummation at a later date, in which case the Trustee shall give notice to

those persons who have appeared at the hearing on confirmation, of the intended date on which the substantial consummation shall occur.

3. All right, title and interest in and to the property dealt with by the Trustee's Plan (a) to the extent transferred at the Transfer Date (as that term is defined in Article I of the Trustee's Plan) shall be vested in New Company at the Closing (as that term is defined in the Settlement Agreement, Document No. A-2412) on the Transfer Date, and said property at said time shall be free and clear of all claims and interests of the Debtor, creditors and stockholders, and (b) to the extent retained by the Trustee following the Transfer Date, but subsequently transferred to the New Company pursuant to order of this Court and Paragraphs 5.3, 5.6, 5.8(a), 7.4, 8.6 and 9.3 of the Trustee's Plan, shall remain vested in the Trustee until said transfer, but upon said transfer shall become subject to the provisions of subpart (a) of this Paragraph 3.

4. (a) The entry of the Order of Substantial Consummation of this Plan pursuant to Section 229(b) of the Bankruptcy Act [11 U.S.C. § 629(b)], shall be a judicial determination of the discharge of all liability and indebtedness of the Debtor and a termination of all rights and interests of the shareholders of the Debtor, except as provided for in the Trustee's Plan, and (b) this Order and the Order of Substantial Consummation pursuant to Section 229(b) of the Bankruptcy Act [11 U.S.C. § 629(b)], when final, shall be a judicial determination of the discharge of all liability and indebtedness of all Subsidiaries (other

BLEED THROUGH

than Equity Funding Life Insurance Company) based upon claims enjoined by Order No. B-0344.

5. That certain Settlement Agreement dated as of September 1, 1974 as amended as of July 10, 1975 and December 8, 1975, and as amended and restated as of February 13, 1976, among Robert M. Loeffler as Trustee and the Creditors in Class 4, in the form filed in these proceedings as Document No. A-2412 is approved.

6. The Trustee is authorized and directed to elect and appoint as directors and officers of the New Company the persons identified on Exhibit 1 hereto.

7. Shares of common stock of the New Company or cash in lieu thereof, and all proceeds thereof, distributed pursuant to paragraph 4.10 of the Trustee's Plan either in the possession of the original distributee or subsequent transferee, shall be free and clear of all claims of creditors of the Debtor based upon any subordination or pay over provision contained in any document pertaining to the debt instruments or to the Debtor's guarantee thereof, described in paragraph 2.9 of the Trustee's Plan, and all creditors are permanently enjoined from enforcing or seeking to enforce any such subordination or pay over provision with respect to any such shares, cash or proceeds distributed pursuant to the Trustee's Plan.

8. This Court reserves the full right and jurisdiction to make at any time and from time to time such orders in aid of consummation of the Trustee's Plan as the Court may deem proper, including, but without limitation, jurisdiction to modify Order No. B-0001, to supervise the Trustee's Plan pursuant to Article

XII thereof, to adjudicate disputes pursuant to Paragraph 14.1, to supervise the administration of the estate pursuant to Paragraph 5.6, to determine claims pursuant to Paragraphs 5.6, 5.8(a), 7.4 and 8.6, to reject executory contracts pursuant to Article VI thereof, to supervise the agreement contemplated by Paragraph 9.3 of the Trustee's Plan, to hear and award fees and expenses pursuant to Section 221(4) of the Bankruptcy Act [11 U.S.C. § 621(4)] and Paragraph 4.1 of the Trustee's Plan, to make permanent that certain preliminary injunction of this Court dated April 11, 1975, being Order No. B-0344, and, prior to the Transfer Date, to authorize the appointment and the selection of up to two additional outside directors of the New Company by *nunc pro tunc* order.

9. The Court reserves jurisdiction to modify the Trustee's Plan to the extent that said modification does not materially or adversely affect the interests of any creditors.

10. The Trustee shall give notice to the Debtor, its creditors, the Securities and Exchange Commission, and the Indenture Trustees of the entry of this Order and of a hearing to be held pursuant to Section 229(b) [11 U.S.C. § 629(b)] of the Bankruptcy Act at 9 o'clock AM on March 31, 1976 in Courtroom 17, United States Courthouse, 312 North Spring Street, Los Angeles, California, 90017 on the Trustee's application for an order declaring the Trustee's Plan to have been substantially consummated under the provisions of Section 229(a) of the Bankruptcy Act [11 U.S.C. § 629(a)].

11. Rule 10-405(b) of the Federal Rules of Bankruptcy Procedure is suspended with respect to all proceedings in the above-entitled matter, and Rule 10-405

BLEED THROUGH

(a) is so suspended insofar as it may be construed to preclude substantial consummation prior to this Order becoming final.

12. The Trustee may have up to 120 days from the date hereof within which to object to proofs of claim filed in accordance with Articles VII and VIII of the Trustee's Plan, and Order No. B-0093 is amended accordingly.

13. Any of the terms set forth in Article I of the Trustee's Plan used herein shall, unless the context otherwise requires, have the meaning specified in said Article I.

DATED: February 23, 1976.

/s/ HARRY PREGERSON
HARRY PREGERSON
United States District Judge

EXHIBIT 1.

DIRECTORS AND OFFICERS
OF NEW COMPANY

DIRECTORS

	Name	Title
1.	Alan R. Gruber	Director/Chairman of the Board
2.	John C. Colman	Director
3.	William F. Good	Director
4.	Robert H. Jeffrey	Director
5.	Bradley T. Jones	Director
6.	Robert Pugmire	Director
7.	R. Donald Reich	Director

OFFICERS

1.	Alan R. Gruber	President and Chief Executive Officer
2.	Donald I. Ingberg	Vice President-Finance Treasurer and Assistant Secretary
3.	William F. Good	Vice President
4.	Robert Pugmire	Vice President
5.	Steven R. Bolson	Secretary

APPENDIX D.

Order in Aid of Substantial Consummation.

United States District Court, Central District of California.

In the Matter of Equity Funding Corporation of America, a Delaware corporation, Debtor.

In Proceedings for the Reorganization of a Corporation. No. 73-03467.

Filed: Feb. 25, 1976.

Pursuant to Paragraphs 2 and 3 of the Order (1) Confirming the Trustee's Plan, (2) Authorizing Substantial Consummation of the Trustee's Plan, (3) Appointing Directors and Officers and (4) Providing for Notice (Order No. B-0567), pursuant to Rule 10-309 of the Federal Rules of Bankruptcy Procedure; upon the prior proceedings heretofore had herein, and a hearing having been held hereon on February 25, 1976;

IT IS HEREBY ORDERED, ADJUDGED AND DECREED as follows:

I.

ACTS TO BE TAKEN BY THE TRUSTEE WITH RESPECT TO THE ORGANIZATION OF THE NEW COMPANY.

1. The Certificate of Amendment to the Certificate of Incorporation (the "Certificate") of the Debtor in the name of Orion Capital Corporation (the "New Company"), substantially in the form of Item 1 in the Compendium of Documents in Aid of Substantial Consummation (the "Compendium") filed February 25, 1976, Document No. A-2427, is hereby approved and the Trustee is authorized and directed to execute

BLEED THROUGH

and acknowledge the Certificate and cause it to be filed and recorded with the appropriate authorities of the State of Delaware, the state of the Debtor's incorporation, and with such other authorities in such other jurisdictions as he may deem appropriate or necessary for the implementation of the Trustee's Amended Plan of Reorganization dated February 23, 1976 (the "Trustee's Plan").

2. The amended By-Laws of the New Company, substantially in the form of Item 2 in the Compendium are hereby approved and the Trustee is authorized and directed on behalf of the New Company to adopt those By-Laws.

3. The Trustee is authorized and directed to take all corporate and other organizational action as he shall deem necessary or appropriate to substantially consummate the Trustee's Plan, and in furtherance thereof is specifically authorized and directed to execute an Instrument Evidencing Corporate Action substantially in the form of Item 3 in the Compendium and such additional documents and instruments as he may from time to time deem necessary or appropriate.

II.

ACTS TO BE TAKEN BY THE TRUSTEE WITH RESPECT TO THE TRANSFER OF ASSETS TO THE NEW COMPANY.

4. The Trustee is hereby authorized and directed to execute and deliver to the New Company, substantially in the form of Item 4 in the Compendium, an Instrument of Transfer, together with such other instruments as may be needed to evidence the transfer of all right, title and interest in and to the record

and beneficial ownership of all of the outstanding capital stock of Bankers National Life Insurance Company, Northern Life Insurance Company, Ankony Angus Corporation and EFC Sponsors Corporation, and such other assets as are to be transferred to the New Company on the Transfer Date.

5. Upon delivery to the New Company the Instrument of Transfer shall be effective to vest all right, title and interest in and to all of the property enumerated therein in the New Company on the Transfer Date free and clear of all mortgages, deeds of trust, pledges, liens, security interests, claims, charges, encumbrances and interests of any kind whatsoever except those provided for in the Trustee's Plan.

6. Upon receipt of net proceeds from the liquidation of Equity Funding Insurance Premium Funding Programs and upon receipt of funds pursuant to Paragraph 2(a) of that certain Compromise Agreement as amended among Equity Funding Life Insurance Company, Fred A. Mauck, Director of Insurance of the State of Illinois, Gleeson L. Payne, Insurance Commissioner of the State of California and the Trustee, the Trustee is hereby authorized and directed to transfer and deliver such funds to the New Company; provided that the Trustee shall not be required to transfer and deliver funds, and may accumulate such funds as received from time to time, until the amount on hand at any one time exceeds $250,000; and, provided further that this Order shall constitute the approval of such transfer and delivery as required by Paragraph 5.6(a) of the Trustee's Plan and no further approval or authorization of this Court shall be necessary at the time the Trustee transfers and delivers such funds to the New Company.

BLEED THROUGH

III.
PROVISIONS WITH RESPECT TO THE DISTRIBUTION OF NOTES OF THE NEW COMPANY.

7. Upon entry of this Order, or at such time thereafter as he shall deem appropriate, the Trustee in his capacity as such, and on behalf of the New Company, is authorized and directed to execute and deliver, as executed, to the Class 4 Creditors enumerated in the Trustee's Plan, or their authorized representatives, the following agreements:

(a) The Senior Secured Note Agreement (the "Senior Note Agreement") among the New Company, the Trustee and the Class 4 Creditors, in substantially the form annexed as Exhibit 2 to the Settlement Agreement among the Trustee and Class 4 Creditors, as amended and restated as of February 13, 1976 and filed as Document No. A-2412 (the "Settlement Agreement").

(b) The Senior Secured Income Note Agreement (the "Income Note Agreement") among the New Company, the Trustee and the Class 4 Creditors, in substantially the form annexed as Exhibit 3 to the Settlement Agreement.

8. On the Transfer Date, the Trustee on behalf of the New Company is authorized and directed to execute and deliver, as executed, to the Class 4 Creditors enumerated in the Trustee's Plan, or their authorized representatives, the following instruments and agreements:

(a) Senior Secured Notes in substantially the form annexed as Exhibit A to the Senior Note Agreement, as provided in Paragraphs 9 and 10

hereof and the Senior Note Pledge Agreement between the New Company and First National City Bank as agent and custodian for the Class 4 Creditors, in substantially the form annexed as Exhibit B to the Senior Note Agreement.

(b) Senior Secured Income Notes in substantially the form annexed as Exhibit A to the Income Note Agreement, as provided in Paragraph 11 hereof and the Pledge Agreement between the New Company and First National City Bank as agent and custodian for the Class 4 Creditors, in substantially the form annexed as Exhibit D to the Income Note Agreement.

9. On the Transfer Date the Trustee is authorized and directed, pursuant to Paragraph 5.2 of the Trustee's Plan and Section 3.01 of the Senior Note Agreement, to cause the New Company to borrow the sum of $2 million from First National City Bank and on behalf of the New Company to execute and deliver to First National City Bank a Senior Secured Note, Series B, in the amount borrowed.

10. On the Transfer Date the Trustee on behalf of the New Company is authorized and directed to execute and deliver to the creditors in Class 4, by delivering to First National City Bank as agent, Senior Secured Notes, Series C and D, of the New Company in an aggregate original principal amount to be determined as provided in Paragraphs 4.5 and 5.2 of the Trustee's Plan, Section 2.01 of the Settlement Agreement and Section 3.01 of the Senior Note Agreement.

11. On the Transfer Date the Trustee on behalf of the New Company is authorized and directed to

BLEED THROUGH

execute and deliver to the creditors in Class 4, by delivering to First National City Bank as agent, Senior Secured Income Notes, Series A and B, of the New Company in the aggregate original principal amount of $27,581,969.05 pursuant to Paragraph 4.5 of the Trustee's Plan, Section 2.04 of the Settlement Agreement and Section 3.01 of the Income Note Agreement.

12. The Trustee in his capacity as such and on behalf of the New Company is authorized and directed to execute and deliver or accept such other instruments of assignment and transfer and such certificates and other documents as are necessary to effect the pledges contemplated by the foregoing agreements, and to consummate the closing of the transactions contemplated by such agreements, including but not limited to the documents hereinafter described:

(a) a letter of direction to the New Company to issue and deliver Stock, Senior Secured Notes, Senior Secured Income Notes and other Loan Documents;

(b) a cross-receipt of New Company for Assets transferred and of the Trustee for Stock;

(c) a request from New Company to First National City Bank for the Start-Up Loan in the principal amount of $2 million;

(d) a certificate as to cash available at the Closing;

(e) a cross-receipt from New Company for the Start-Up Loan and the Senior Note, Series B;

(f) the acknowledgment and acceptance of the transmittal letter of First National City Bank, as agent, transmitting notes and collateral of the Debtor;

(g) a letter from New Company to First National City Bank, as agent, transmitting Senior Notes, Income Notes, the collateral therefor and documents relating thereto;

(h) a certificate on behalf of the New Company pursuant to Section 7.04(c)(iii) of the Senior Note Agreement and Section 7.03(b)(iii) of the Income Note Agreement; and

(i) a certificate of substantial consummation of the Trustee's Plan pursuant to Section 7.04 (d) of the Senior Note Agreement and Section 7.03(c) of the Income Note Agreement.

All such documents shall be substantially in the form of Item 5 in the Compendium. Also in connection therewith the Trustee is authorized and directed to deliver stock certificate No. A-1 to Bankers, stock certificates Nos. 7094, 7103, 7104, 7105 and 7106 to Northern, stock certificate No. 7 to Ankony Angus Corporation and stock certificate No. 2 to EFC Sponsors Corporation, in each case with directions to the respective issuer to cancel such certificates and to issue in substitution therefor new stock certificates registered in the name of the New Company for all of the issued and outstanding capital stock of the respective issuers thereof and to accept and acknowledge from Bankers, Northern, Ankony and EFC Sponsors letters from the Presidents thereof and Officers' Certificates thereof signifying such cancellation of old certificates and issuance of new certificates in the name of the New Company. Further in connection therewith the Trustee is authorized and directed to deliver such aforementioned stock certificates registered in the name of the New Company to the New Company together

BLEED THROUGH

with the Instrument of Transfer and thereupon to execute and deliver on behalf of the New Company:

(i) a letter requesting Northern to cancel the stock certificate registered in the name of the New Company and requesting a new certificate registered in the name of King & Co. representing all of the issued and outstanding shares of capital stock of Northern and to acknowledge and accept the same and thereupon to cause the New Company to deliver the same to First National City Bank as custodian under the Pledge Agreement;

(ii) a letter requesting Bankers to cancel the stock certificate registered in the name of the New Company and requesting a new certificate registered in the name of King & Co. representing all of the issued and outstanding shares of capital stock of Bankers and to acknowledge and accept the same and thereupon to cause the New Company to deliver the same to First National City Bank as custodian under the Pledge Agreement;

(iii) a letter requesting Ankony to cancel the stock certificate registered in the name of the New Company and requesting a new certificate registered in the name of King & Co. representing all of the issued and outstanding shares of capital stock of Ankony and to acknowledge and accept the same and thereupon to cause the New Company to deliver the same to First National City Bank as custodian under the Senior Note Pledge Agreement; and

(iv) a letter requesting EFC Sponsors to cancel the stock certificate registered in the name of the New Company and requesting a new certificate

registered in the name of King & Co. representing all of the issued and outstanding shares of capital stock of EFC Sponsors and to acknowledge and accept the same and thereupon to cause the New Company to deliver the same to First National City Bank as custodian under the Senior Note Pledge Agreement.

The Trustee, in his capacity as sole stockholder of Ankony Angus Corporation and Ankony Cattle Management Company, is authorized and directed to consent to mortgages to be executed by Ankony Angus Corporation pursuant to Paragraph 6.04(b) of the Senior Note Agreement. Nothing contained in this paragraph shall be construed to prohibit the Trustee from executing, accepting or delivering those other documents or doing those other acts he deems to be necessary or proper to effect Substantial Consummation of the Trustee's Plan.

IV.
PROVISIONS WITH RESPECT TO DISTRIBUTION OF CASH.

13. On the Transfer Date the Trustee is authorized and directed to release to the Creditors in Class 3 the security held by them described in Item 6 in the Compendium.

14. On the Transfer Date, pursuant to paragraph 5.2 of the Trustee's Plan, the Trustee is authorized and directed to set aside (a) an amount to be reasonably estimated by him to be sufficient to pay all administrative allowances and all costs and expenses of administration incurred prior to the Transfer Date, (b) the amount of $500,000 for the purposes set forth in

BLEED THROUGH

Paragraph 4.14 (d) of the Trustee's Plan, (c) the amount of $250,000 for the settlement of the Multi-District Actions as provided in Paragraph 9.1 of the Trustee's Plan, to be held by him until further order of this court and (d) the amount of $4,000,000 to finance the Trustee's costs and expenses continuing after the Transfer Date. On the Transfer Date or as soon as reasonably practicable thereafter, the Trustee is authorized and directed to distribute out of the cash on hand as of the opening of business on the Transfer Date the following amounts in the following manner:

(a) To each of the creditors in Classes 1 and 2 the amount provided in a schedule to be filed with this Court within 25 days following the entry of this Order by depositing a check therefor in the United States mail, first class postage prepaid, addressed to each such creditor.

(b) To the creditors in Class 4.1 the aggregate amount of $350,000, allocated between them in proportion to the principal amount of their respective allowed claims, by depositing a check for the amount to which each such creditor is entitled in the United States mail, first class postage prepaid, addressed to each such creditor.

(c) To each of the creditors in Class 6.1 the amounts provided in a schedule to be filed with this Court within 25 days following the entry of this Order, depositing a check therefor in the United States mail, first class postage prepaid, addressed to each such creditor.

(d) For the benefit of the creditors in Class 4 to First National City Bank as agent the amount

of cash payable to such creditors pursuant to Paragraphs 4.5 and 5.2 of the Trustee's Plan and Section 2.01(c) of the Settlement Agreement by authorizing First National City Bank as agent for the Class 4 creditors to debit an account of the Trustee at First National City Bank such amount of cash payable to the Class 4 creditors.

V.

PROVISIONS WITH RESPECT TO DISTRIBUTION OF COMMON STOCK OF NEW COMPANY.

15. On the Transfer Date the Trustee is authorized and directed on behalf of the New Company to issue in his own name, as Trustee, up to 9,000,000 shares of the common stock, $1 par value, of the New Company.

16. On or after the Transfer Date the Trustee is authorized and directed to distribute in accordance with the provisions of Trustee's Plan in the manner as shall be specified by further order of this Court to the creditors in Classes 5, 6, 7 and 8 of their respectives shares held by him of the common stock of the New Company.

VI.

PROVISIONS WITH RESPECT TO CANCELLATION OF OUTSTANDING STOCKS, NOTES AND DEBENTURES OF EFCA.

17. All of Debtor's $.30 par value common stock, Series A and Series B Convertible Preferred Shares, Debtor's common stock purchase warrants (expiring

BLEED THROUGH

1975), and all options to purchase Debtor's common stock are cancelled effective as of the Closing as that term is defined in the Settlement Agreement.

18. All Debtor's 9½% Debentures due 1990 are cancelled effective as of the Closing.

19. All Debtor's 5½% Convertible Subordinated Debentures due 1991 are cancelled effective as of the Closing.

20. All 5¼% NV Guaranteed (subordinated) Debentures due 1989 are cancelled effective as of the Closing.

21. Any and all other securities, notes, indebtedness and other obligations of the Debtor are cancelled as of the Closing, provided, however, that nothing herein shall be construed to affect the rights of the holders of the Custodial Collateral Notes and NEMB arising under that certain Settlement Agreement dated April 25, 1975, among holders of Custodial Collateral Notes, NEMB and the Trustee.

VII.

PROVISIONS WITH RESPECT TO ADMINISTRATION OF THE DEBTOR ESTATE, THE DISCHARGE OF THE TRUSTEE, AND JURISDICTION OF THE COURT OVER NEW COMPANY.

22. At all times prior to the Closing, the Trustee shall continue to have full title to all of the assets of the Debtor and control over all of the business operations of the Debtor and shall exercise, subject to the control of this Court, all of the powers vested in him by Chapter X of the Bankruptcy Act and

all orders of this Court heretofore or hereafter entered, over all of said assets and said business operations of the Debtor.

23. Subsequent to the Closing, the Trustee shall not have any further duties and responsibilities in respect of the administration of the property, and of the conduct of the business and affairs, transferred by him to New Company on the Transfer Date. Thereupon, all corporate power and authority of the New Company shall be vested in and exercised by the stockholders, directors, and officers of the New Company, and the Trustee shall no longer have any power or authority to take action, pursuant to Section 303 of the General Corporation Law of the State of Delaware or otherwise, on behalf of or with respect to the New Company.

24. Subsequent to the Closing, the possession by the New Company of its assets and the conduct of its business and affairs shall be free and clear of the control of this Court.

25. Until further order of this Court:

(a) The Trustee, his general counsel and his court-appointed accountants shall be permitted to inspect and copy any and all of the books, files, records and papers of the New Company, pertaining to any matter or thing whatsoever occurring prior to the Transfer Date; and

(b) Upon request by the Trustee, his general counsel or his court-appointed accountants, the New Company shall furnish or cause to be furnished to said requesting party such statistical or other information relating to any such matter or thing as may be so requested.

BLEED THROUGH

26. Except to the extent specifically provided in this Article VII, following the Transfer Date the Trustee shall continue to have full title to, and shall exercise, subject to the control of this Court, all of the powers vested in him by Chapter X of the Bankruptcy Act and all orders of this Court heretofore or hereafter entered, with respect to all property retained by him subsequent to the Transfer Date until such time as the Trustee shall, pursuant to the provisions of the Trustee's Plan, transfer said property, if at all, to the New Company or otherwise.

VIII.
PROVISIONS WITH RESPECT TO INJUNCTIONS.

27. As of the Closing the provisions of Paragraph V of Order No. B-0001 shall be of no further force and effect with respect to all of the property transferred to the New Company; provided, however, that such injunction shall continue in full force and effect as to all property not transferred by the Trustee as of the Transfer Date.

28. As of the Closing the provisions of Paragraph XIV of Order No. B-0001 shall be of no further force and effect as to all of the property transferred by the Trustee with respect to any claim for relief arising subsequent to Closing on the Transfer Date; provided, however, that except as herein provided said injunction shall continue in full force and effect and is hereby made permanent.

IX.

MISCELLANEOUS PROVISIONS.

29. Any of the terms set forth in Article 1 of the Trustee's Plan used herein shall, unless the context otherwise requires, have the meaning specified in that Article.

30. The Trustee as Trustee, and on behalf of the New Company through the Closing, is hereby authorized and directed to take all such action as may be necessary or proper in order to put into effect and carry out the Trustee's Plan.

31. Notice of the entry of this Order shall be served upon the Plan Service List.

DATED: February 25, 1976.

/s/ HARRY PREGERSON
HARRY PREGERSON
UNITED STATES DISTRICT JUDGE

BLEED THROUGH

APPENDIX E.

Memorandum and Order on Objection to Claim No. C-0663 Filed on Behalf of Marvin Al Lichtig.

United States District Court, Central District of California.

In the Matter of Equity Funding Corporation of America, a Delaware corporation, Debtor.

In Proceedings for the Reorganization of a Corporation. No. 73-03467.

The debtor proceeding was filed on April 5, 1973, under Chapter X of the Bankruptcy Act (11 U.S.C. 501-676). On April 10, 1973, an order was entered by the district court judge appointing Robert M. Loeffler trustee in this debtor proceeding (Document Nos. A-0006 and B-0006). On May 1, 1973, an order was entered setting a hearing for June 4, 1973, pursuant to Section 161 of the Bankruptcy Act (11 U.S.C. 561), setting June 19, 1973, as the bar date for the filing of general unsecured claims, and prescribing the form and manner of giving notice to creditors respecting the bar date (Document Nos. A-0060-A and B-0032).

On November 1, 1973, a Federal Grand Jury returned an indictment in the United States District Court for the Central District of California in the Matter of *United States of America vs. Stanley Goldblum* and twenty-one (21) other defendants, No. 13390CD. Mr. Lichtig, a former independent auditor, employee, and officer of the debtor, was charged in thirteen (13) of the one-hundred-and-five counts in that indictment. The indictment charged Mr. Lichtig with fraud in issuing false financial statements in the registration and sale of securities of the debtor corporation prior to the filing of this debtor proceeding.

On December 5, 1974, Richard A. DeSantis, Esquire, counsel for Mr. Lichtig, filed a claim in this proceeding in the sum of $750,000,000. Said claim was assigned No. C-0663. The claim states that it is a general unsecured claim. The claim alleges that the claimant was damaged due to the fraud of debtor, its officers, directors, employees, and agents.

Trial of the criminal matter (CR-13390JWC) began on January 7, 1975, and was concluded on May 20, 1975, with the jury returning a verdict of guilty on thirteen (13) counts. On July 16, 1975, sentence was pronounced by the Honorable Jesse W. Curtis, United States District Court Judge. An appeal of this conviction is now pending before the United States Court of Appeals for the Ninth Circuit.

On December 1, 1975, the trustee filed objections to the claim of Mr. Lichtig. The objection was dated November 25, 1975. Hearing on the objection was set for December 12, 1975, at 9:30 a.m., in the Courtroom of the undersigned.

Here it might be well to clear up some misconceptions counsel may have about the role of a bankruptcy judge hearing objections to claims in a Chapter X proceeding. The hearing on claims filed in a proceeding are not one of the duties under the exclusive jurisdiction of the Reorganization Judge (district court judge). Indeed, this activity is one in which the bankruptcy judge hears as a bankruptcy judge and not as special master.

At the hearing on December 12, 1975, counsel for the claimant requested a continuance. This Court granted a continuance to January 5, 1976. An order

BLEED THROUGH

to that effect was entered on December 12, 1975 (Document No. A-2257). This order further provided for the claimant to file a statement to be signed by the claimant setting forth in detail the nature of his claim. An amended proof of claim was filed on December 30, 1975, in the sum of $750,000. On January 5, 1976, claimant filed a further amendment increasing the amount of the claim to $750,000,000.

At the hearing on January 5, 1976, the claimant was represented by Paul R. Salerno, Esquire, of the law offices of Richard A. DeSantis. The trustee was represented by the law firm of O'Melveny & Myers by Everett B. Clary, Esquire, and Frederick W. Lambert, Esquire. At that hearing, the Court heard statement by counsel and a request that judicial notice be taken of the criminal matters which resulted in the conviction of Mr. Lichtig. The matter was then taken under submission to permit counsel for the claimant to file an additional brief on or before January 9, 1976. Counsel also sought a further continuance.

The briefs filed in this matter have been voluminous and deal with many matters not properly before this Court. The question of whether the claimant was properly convicted and the fairness of the provision of the Plan of Corporate Reorganization in relation to indemnity and contribution are matters that have been determined in other proceedings in other courts.

The final procedural problem relates to a proposed order prepared by counsel for the trustee. This order was never lodged with the Court. In matters of this nature, this Court prefers to prepare its own memoranda and has done so in this case.

The five issues before the Court are as follows:

1. Was the claim timely filed?
2. Does the claim and the amendments thereto set forth a statement in sufficient detail to show that the amount thereof, or any portion of it, is justly owing from the debtor to the claimant?
3. Does the claim of fraud have merit in light of the criminal conviction of the claimant?
4. May claims for indemnity and contribution be allowed other than as provided in the Plan of Reorganization?
5. Even if allowable, does the conviction of the claimant bar the claimant from recovery under the doctrine of equitable subordination?

Each of the above are legal questions which this Court may decide on the record now before the Court.

This Court rules that the first four questions must be answered in the negative, and the fifth must be answered in the affirmative, for the reasons stated below. In so ruling, this Court takes judicial notice of the proceeding in *United States of America vs. Stanley Goldblum*. Accordingly, it is unnecessary for the trustee to adduce evidence in these proceedings respecting the matters determined in that case.

1. There can be no question about the timeliness in the filing of this claim. The bar date for unsecured claims was June 19, 1973. This claim was not filed until December 5, 1974. On this basis alone, the objections of the trustee are sustained.

2. The total liability of the debtor to all classes of creditors is estimated to be three-quarters of one

BLEED THROUGH

billion dollars, or $750,000,000. Here the claimant seeks a like amount but in two attempts has failed to detail the nature of the claim except in broad and obscure generalities.

3. The claim seems to assert that the claimant was somehow victimized by the EFCA fraud, giving rise to a claim for fraud, breach of contract, compensation, indemnification, and contribution. While, as noted above, the nature of the claim cannot be discerned from a reading of it, one thing is plain. Since the claimant has been found to be one of the perpetrators of the fraud, he could not have been one of its victims.

4. The Plan of Reorganization, approved by this Court by Order No. B-0527, dated December 8, 1975, makes no provision for claims for contribution and makes provision for claims for indemnity in specified circumstances, which the claim here in question does not meet. The propriety of the Plan in these respects is a matter that could and should have been litigated in the Plan approval hearings.

5. Counsel for the claimant seems to be under the impression that only a fraud conviction would justify the subordination of this claim if allowed. In reviewing this problem, the Ninth Circuit in the case of *Frasher vs. Robinson* (1972), 458 F.2d 492, stated at page 493:

> "Claims of majority shareholders will be subordinated when the majority shareholders have been involved in fraud, overreaching, or other inequitable conduct. Pepper v. Litton, 308 U.S. 295, 60 S.Ct. 238, 84 LEd. 281 (1939)."

If the *Frasher* case has any meaning, it is that persons holding the position similar to that held by

Mr. Lichtig may have their claims subordinated by conduct that is less than fraudulent. It appears to this Court that the conduct of which Mr. Lichtig was convicted was plainly fraudulent. However, even if it was not, he was found to be responsible, at least in part, for the EFCA fraud. Therefore, on the present record, and taking judicial notice of the indictment and conviction of the claimant, his claim, if allowed, is subordinated.

The Plan of Corporate Reorganization represents a compromise of disputed issues respecting the application of the absolute priority rule. As a result, creditors of all classes who are not equitably subordinated share in varying proportions in the assets available to the entire creditor body. In applying the rule of subordination in a bankruptcy proceeding, all creditors must be paid in full before a subordinated creditor may share in the residue of the estate. Since the Plan of Reorganization does not propose to pay any creditors in full, there would be no excess assets to pay a subordinated creditor.

The claim on file is an unsecured claim. This Court does not know whether Mr. Lichtig is the holder of any shares, debentures, or other securities issued by the debtor. If the claimant does own such securities, then a claim must be filed pursuant to Notice to Creditors filed by the trustee on December 10, 1975 (Document Nos. A-2251 and B-0529). Since a shareholder claim is not before this Court, nothing contained in this Memorandum shall be deemed a ruling on such a claim.

At the conclusion of the hearing on January 5, 1976, the Court learned that joint applications or

BLEED THROUGH

ex-parte orders had been filed on behalf of the claimant herein and Curtis B. Danning, trustee in the bankrupt estate of Solomon Block. These documents seek to institute ancillary proceedings in other jurisdictions and require the trustee to produce certain witnesses. Approval or rejection of these documents has been withheld pending a determination of the other problems covered by this Memorandum and Order. The rulings hereinabove on those matters render these applications moot.

Now, therefore, it is ordered that the trustee's objection to Claim No. C-0663 filed on behalf of Marvin Al Lichtig is sustained and said claim is disallowed in its entirety; and

It is further ordered that the Ex Parte Motion for Authority to Institute Ancillary Proceedings, the Ex Parte Motion Compelling Trustee in Reorganization to Produce Certain Witnesses, and the Ex Parte Motion to Produce Robert Loeffler, Everett Clary, and Robert Pisano are denied.

DATED: Jan. 15, 1976.

/s/ James E. Moriarty
JAMES E. MORIARTY
Bankruptcy Judge

APPENDIX F.

Memorandum and Order on Objection to Claim No. C-0661 Filed on Behalf of Curtis B. Danning, Trustee for Solomon Block, Bankrupt.

United States District Court, Central District of California.

In the Matter of Equity Funding Corporation of America, a Delaware corporation, Debtor.

In Proceedings for the Reorganization of a Corporation. No. 73-03467.

The debtor proceeding was filed on April 5, 1973, under Chapter X of the Bankruptcy Act (11 U.S.C. 501-676). On April 10, 1973, an order was entered by the district court judge appointing Robert M. Loeffler trustee in this debtor proceeding (Document Nos. A-0006 and B-0006). On May 1, 1973, an order was entered setting a hearing for June 4, 1973, pursuant to Section 161 of the Bankruptcy Act (11 U.S.C. 561), setting June 19, 1973, as the bar date for the filing of general unsecured claims, and prescribing the form and manner of giving notice to creditors respecting the bar date (Document Nos. A-0060-A and B-0032).

On November 1, 1973, a Federal Grand Jury returned an indictment in the United States District Court for the Central District of California in the Matter of *United States of America vs. Stanley Goldblum* and twenty-one (21) other defendants, No. 13390CD. Solomon Block, a former employee of the accounting firm of Wolfson, Weiner, Ratoff & Lapin, the independent auditors of the debtor, was charged in seven (7) of the one-hundred-and-five counts in

BLEED THROUGH

that indictment. The indictment charged Mr. Block with fraud in preparing false financial statements in the registration and sale of securities of the debtor corporation prior to the filing of this debtor proceeding.

The claimant herein, Curtis B. Danning, is the trustee in the bankrupt estate of Solomon Block. The Block bankruptcy was filed on November 14, 1973 (No. 73-13117). Counsel for the bankrupt was the law firm of Niesen & Golden. The First Meeting of Creditors was held on December 11, 1973. The trustee filed his No-Asset Report on March 12, 1974; and this report was vacated on November 12, 1974. Shortly before the vacating of the No-Asset Report, on October 31, 1974, the law firm of Sands, Pachter & Gold was appointed special counsel for the trustee. Nathan Markowitz, Esquire, was an associate of that firm and Judith A. Gilbert, Esquire, was then an associate, or became an associate of the law firm shortly thereafter.

Prior to the employment of special counsel, Mr. Markowitz of that firm was representing Mr. Block in civil matters relating to the Equity case and was representing Mr. Block in the criminal proceeding discussed herein. Since the employment of special counsel, Mr. Markowitz and Miss Gilbert have been associated with several law firms and are now practicing law under the firm name of Abeles & Markowitz. On November 21, 1975, Abeles & Markowitz were substituted in as bankruptcy counsel for Solomon Block succeeding original counsel, Niesen & Golden.

On November 25, 1974, Nathan Markowitz, special counsel for Curtis B. Danning, trustee in the bankruptcy estate of Solomon Block, filed a claim in this proceeding in the sum of $800,000,000. Said claim

was assigned No. C-0661. The claim states that it is a general unsecured claim. The claim alleges Mr. Block was damaged due to the fraud of the debtor, its officers, directors, employees, and agents.

Trial of the criminal matter (CR-13390JWC) began on January 7, 1975, and was concluded on May 20, 1975, with the jury returning a verdict of guilty on seven (7) counts. On July 16, 1975, sentence was pronounced by the Honorable Jesse W. Curtis, United States District Court Judge. An appeal of this conviction is now pending before the United States Court of Appeals for the Ninth Circuit.

On December 1, 1975, the trustee filed objections to the claim of Mr. Block. The objection was dated November 25, 1975. Hearing on the objection was set for December 12, 1975, at 9:30 a.m., in the Courtroom of the undersigned.

Here it might be well to clear up some misconceptions counsel may have about the role of a bankruptcy judge hearing objections to claims in a Chapter X proceeding. The hearing on claims filed in a proceeding are not one of the duties under the exclusive jurisdiction of the Reorganization Judge (district court judge). Indeed, this activity is one in which the bankruptcy judge hears as a bankruptcy judge and not as special master.

At the hearing on December 12, 1975, counsel for the claimant requested a continuance. This Court granted a continuance to January 5, 1976. An order to that effect was entered on December 12, 1975 (Document No. A-2258). This order further provided for the claimant to file a statement to be signed by the claimant setting forth in detail the nature of his

BLEED THROUGH

claim. An amended proof of claim was filed on December 30, 1975, in the sum of $800,000. On January 5, 1976, claimant filed a further amendment increasing the amount of the claim to $800,000,000.

At the hearing on January 5, 1976, the claimant was represented by Judith A. Gilbert, Esquire, of the law firm of Abeles & Markowitz. The trustee was represented by the law firm of O'Melveny & Myers by Everett B. Clary, Esquire, and Frederick W. Lambert, Esquire. At that hearing, the Court heard statement by counsel and a request that judicial notice be taken of the criminal matters which resulted in the conviction of Mr. Block. The matter was then taken under submission to permit counsel for the claimant to file an additional brief on or before January 9, 1976. Counsel also sought a further continuance.

The briefs filed in this matter have been voluminous and deal with many matters not properly before this Court. The question of whether the claimant was properly convicted and the fairness of the provisions of the Plan of Corporate Reorganization in relation to indemnity and contribution are matters that have been determined in other proceedings in other courts.

The final procedural problem relates to a proposed order prepared by counsel for the trustee. This order was never lodged with the Court. In matters of this nature, this Court prefers to prepare its own memoranda and has done so in this case.

The five issues before the Court are as follows:

1. Was the claim timely filed?
2. Does the claim and the amendments thereto set forth a statement in sufficient detail to

show that the amount thereof, or any portion of it, is justly owing from the debtor to the claimant?

3. Does the claim of fraud have merit in light of the criminal conviction of Solomon Block?

4. May claims for indemnity and contribution be allowed other than as provided in the Plan of Reorganization?

5. Even if allowable, does the conviction of Solomon Block bar the claimant from recovery under the doctrine of equitable subordination?

Each of the above are legal questions which this Court may decide on the record now before the Court.

This Court rules that the first four questions must be answered in the negative, and the fifth must be answered in the affirmative, for the reasons stated below. In so ruling, this Court takes judicial notice of the proceeding in *United States of America vs. Stanley Goldblum*. Accordingly, it is unnecessary for the trustee to adduce evidence in these proceedings respecting the matters determined in that case.

1. There can be no question about the timeliness in the filing of this claim. The bar date for unsecured claims was June 19, 1973. This claim was not filed until November 25, 1974. On this basis alone, the objections of the trustee are sustained.

2. The total liability of the debtor to all classes of creditors is estimated to be three-quarters of one billion dollars, or $750,000,000. Here the claimant seeks the sum of $800,000,000 but in two attempts has failed to detail the nature of the claim except in broad and obscure generalities.

BLEED THROUGH

3. The claim seems to assert that Solomon Block was somehow victimized by the EFCA fraud, giving rise to a claim for fraud, breach of contract, indemnification, and contribution. While, as noted above, the nature of the claim cannot be discerned from a reading of it, one thing is plain. Since Mr. Block has been found to be one of the perpetrators of the fraud, he could not have been one of its victims and his bankruptcy trustee has no standing to assert this claim.

4. The Plan of Reorganization, approved by this Court by Order No. B-0527, dated December 8, 1975, makes no provision for claims for contribution and makes provision for claims for indemnity in specified circumstances, which the claim here in question does not meet. The propriety of the Plan in these respects is a matter that could and should have been litigated in the Plan approval hearings.

5. Counsel for the claimant seems to be under the impression that only a fraud conviction would justify the subordination of this claim if allowed. In reviewing this problem, the Ninth Circuit in the case of *Frasher vs. Robinson* (1972), 458 F.2d 492, stated at Page 493:

> "Claims of majority shareholders will be subordinated when the majority shareholders have been involved in fraud, overreaching, or other inequitable conduct. Pepper v. Litton, 308 U.S. 295, 60 S.Ct. 238, 84 L.Ed. 281 (1939)."

If the *Frasher* case has any meaning, it is that persons holding the position similar to that held by Mr. Block may have their claims subordinated by conduct that is less than fraudulent. It appears to this Court

that the conduct of which Mr. Block was convicted was plainly fraudulent. However, even if it was not, he was found to be responsible, at least in part, for the EFCA fraud. Therefore, on the present record, and taking judicial notice of the indictment and conviction of Solomon Block, this claim, if allowed, is subordinated.

The Plan of Corporate Reorganization represents a compromise of disputed issues respecting the application of the absolute priority rule. As a result, creditors of all classes who are not equitably subordinated share in varying proportions in the assets available to the entire creditor body. In applying the rule of subordination in a bankruptcy proceeding, all creditors must be paid in full before a subordinated creditor may share in the residue of the estate. Since the Plan of Reorganization does not propose to pay any creditors in full, there would be no excess assets to pay a subordinated creditor.

As the conclusion of the hearing on January 5, 1976, the Court learned that joint applications or ex-parte orders had been filed on behalf of the claimant herein and Marvin Al Lichtig. These documents seek to institute ancillary proceedings in other jurisdictions and require the trustee to produce certain witnesses. Approval or rejection of these documents has been withheld pending a determination of the other problems covered by this Memorandum and Order. The rulings hereinabove on those matters render these applications moot.

Now, Therefore, It Is Ordered that the trustee's objection to Claim No. C-0661 filed on behalf of Curtis B. Danning, trustee of the bankrupt estate

BLEED THROUGH

of Solomon Block, is sustained and said claim is disallowed in its entirety; and

It Is Further Ordered that the Ex Parte Motion for Authority to Institute Ancillary Proceedings, the Ex Parte Motion Compelling Trustee in Reorganization to Produce Certain Witnesses, and the Ex Parte Motion to Produce Robert Loeffler, Everett Clary, and Robert Pisano are denied.

Dated: January 15, 1976.

/s/ James E. Moriarty
James E. Moriarty
JAMES E. MORIARTY
Bankruptcy Judge